Internal Revenue
cumulative
bulletin

1982-1

january-june

Department of the Treasury
Internal Revenue Service

In This Issue

Statement of Principles of Internal Revenue Tax Administration ii

Introduction iii

Definition of Terms and Abbreviations iv

Numerical Finding List v

Finding List of Current Action on Previously Published Rulings vii

Tax Court 1

Part I.—Rulings and Decisions Under the Internal Revenue Code of 1954 3

Part II.—Treaties and Tax Legislation
- Table of Contents 217
  - Subpart A.—Tax Conventions 219
  - Subpart B.—Legislation and Related Committee Reports 305

Part III.—Administrative, Procedural and Miscellaneous 331
- Table of Contents 329

Notice of Proposed Rulemaking 515

Disbarments and Suspensions List 574

Index 577

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C. 20402

READEX FICHE

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

These principles of tax administration were previously published in the Internal Revenue Bulletin as Revenue Procedure 64-22, 1964-1 (Part I) C.B. 689. They are restated here to emphasize their importance to all employees of the Internal Revenue Service.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that effect the rights and duties of taxpayers are published.

Revenue Rulings represent the conclusions of the Service on the application of the law to the entire state of facts involved. In those that are based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and confidential information are deleted to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

Cumulative Bulletin 1982-1 is a consolidation of all items of a permanent nature published in the weekly Bulletins 1982-1 through 1982-26 for the period of January 1 through June 30, 1982. It includes a cumulative list of announcements relating to decisions of the Tax Court published in the Internal Revenue Bulletins.

The Internal Revenue Cumulative Bulletin is prepared in three parts as follows:

Part I.—1954 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954. Arrangement is sequential according to Code and regulations sections. The Code section is shown at the top of each page.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Included in this Part is a list of persons disbarred or suspended from practice before the Internal Revenue Service.

Notice of Proposed Rulemaking
The preambles and text of proposed regulations that were published in the **Federal Register** during this six-month period are printed in this section.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

The synopses preceding Revenue Rulings, Revenue Procedures, and Court Decisions are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

The contents of this publication are not copyrighted and may be reprinted freely; a citation of the Cumulative Bulletin as the source would be appropriate.

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above.)

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Consel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim.—Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transactions Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales tax ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

Numerical Finding List

Committee Reports
Conference:
97-409 (PL 97-123), **315**

House:
97-312 (PL 97-164), **320**
97-406 Part 1 (PL 97-119), **311**

Court Decisions:
2010, **121**
2011, **148**
2012, **142**

Delegation Orders:
4 (Rev. 13), **331**
5 (Rev. 10), **332**
8 (Rev. 8), **333**
11 (Rev. 13), **333**
14 (Rev. 2), **333**
35 (Rev. 12), **334**
42 (Rev. 15), **334**
42 (Rev. 16), **334**
57 (Rev. 5), **335**
77 (Rev. 15), **335**
88 (Rev. 6), **335**
93 (Rev. 8), **336**
96 (Rev. 6), **336**
97 (Rev. 19), **337**
100 (Rev. 3), **338**
107 (Rev. 6), **339**
109 (Rev. 6), **339**
112 (Rev. 7), **339**
113 (Rev. 7), **340**
114 (Rev. 3), **341**
116 (Rev. 5), **341**
130 (Rev. 2), **341**
136 (Rev. 4), **341**
139 (Rev. 6), **342**
143 (Rev. 1), **342**
144 (Rev. 1), **342**
154 (Rev. 1), **342**
155 (Rev. 1), **342**
156 (Rev. 2), **343**
156 (Rev. 2), Amend. 1, **349**
157 (Rev. 3), **350**
160 (Rev. 3), **350**
182 (Rev. 1), **350**
190, **350**
191, **352**

Executive Orders:
12359, **352**

Notices:
82-1, **353**
82-2, **353**
82-3, **353**
82-4, **356**
82-5, **356**
82-6, **356**
82-7, **356**
82-8, **357**
82-9, **358**
82-10, **359**
82-11, **359**
82-12, **359**
82-13, **360**
82-14, **366**

Prohibited Transaction Exemptions:
81-82, **177**

Proposed Regulations:
EE-11-78, **515**
EE-69-80, **516**
EE-153-81, **517**
LR-201-76, **519**
LR-74-77, **520**
LR-83-80, **522**
LR-176-80, **526**
LR-6-81, **530**
LR-75-81, **531**

Proposed Regulations—Continued
LR-111-81, **557**
LR-120-81, **559**
LR-160-81, **560**
LR-161-81, **561**
LR-189-81, **565**
LR-192-81, **566**
LR-276-81, **567**
LR-311-81, **570**
LR-313-81, **572**
LR-4-82, **573**

Public Laws:
97-21, **305**
97-51, **306**
97-92, **306**
97-119, **307**
97-123, **314**
97-164, **316**

Railroad Retirement Quarterly Rate:
153

Revenue Procedures:
82-1, **366**
82-2, **367**
82-3, **368**
82-4, **380**
82-5, **406**
82-6, **409**
82-7, **410**
82-8, **413**
82-9, **413**
82-10, **414**
82-11, **429**
82-12, **429**
82-13, **447**
82-14, **459**
82-15, **460**
82-16, **461**
82-17, **462**
82-18, **463**
82-19, **463**
82-20, **466**
82-21, **468**
82-22, **469**
82-23, **474**
82-24, **474**
82-25, **475**
82-26, **476**
82-27, **480**
82-28, **480**
82-29, **481**
82-30, **485**
82-31, **486**
82-32, **486**
82-33, **489**
82-34, **489**
82-35, **489**
82-36, **490**
82-37, **491**
82-38, **503**

Revenue Rulings:
82-1, **26**
82-2, **27**
82-3, **93**
82-4, **99**
82-5, **131**
82-6, **137**
82-7, **167**
82-8, **9**
82-9, **39**
82-10, **46**
82-11, **51**
82-12, **52**
82-13, **132**
82-14, **210**
82-15, **29**
82-16, **106**
82-17, **95**

Revenue Ruling—Continued
82-18, **107**
82-19, **169**
82-20, **6**
82-21, **17**
82-22, **33**
82-23, **139**
82-24, **134**
82-25, **214**
82-26, **114**
82-27, **32**
82-28, **11**
82-29, **200**
82-30, **165**
82-31, **166**
82-32, **66**
82-33, **28**
82-34, **59**
82-35, **128**
82-36, **146**
82-37, **214**
82-38, **96**
82-39, **119**
82-40, **175**
82-41, **183**
82-42, **77**
82-43, **10**
82-44, **18**
82-45, **89**
82-46, **158**
82-47, **201**
82-48, **211**
82-49, **5**
82-50, **6**
82-51, **117**
82-52, **168**
82-53, **210**
82-54, **11**
82-55, **12**
82-56, **17**
82-57, **24**
82-58, **27**
82-59, **47**
82-60, **63**
82-61, **13**
82-62, **130**
82-63, **135**
82-64, **154**
82-65, **213**
82-66, **61**
82-67, **32**
82-68, **81**
82-69, **102**
82-70, **114**
82-71, **185**
82-72, **57**
82-73, **83**
82-74, **110**
82-75, **116**
82-76, **118**
82-77, **211**
82-78, **30**
82-79, **8**
82-80, **89**
82-81, **109**
82-82, **127**
82-83, **151**
82-84, **208**
82-85, **137**
82-86, **188**
82-87, **189**
82-88, **190**
82-89, **191**
82-90, **192**
82-91, **193**
82-92, **194**
82-93, **196**
82-94, **31**
82-95, **101**

Numerical Finding List—Continued

Revenue Rulings—Continued
82-96, 113
82-97, 138
82-98, 141
82-99, 154
82-100, 155
82-101, 21
82-102, 62
82-103, 34
82-104, 129
82-105, 133
82-106, 16
82-107, 103
82-108, 3
82-109, 7
82-110, 33
82-111, 48
82-112, 59
82-113, 78
82-114, 104
82-115, 108
82-116, 152
82-117, 19
82-118, 56
82-119, 105
82-120, 203
82-121, 79
82-122, 80
82-123, 82
82-124, 89
82-125, 64
82-126, 204
82-127, 215

Tax Conventions:
Egypt, 219
Jamaica, 257

Treasury Decisions:
7798, 197
7799, 67
7800, 35
7801, 60
7802, 53
7803, 155
7804, 159
7805, 112
7806, 91
7807, 41
7808, 204
7809, 170
7810, 49
7811, 186
7812, 147
7813, 160
7814, 84
7815, 120
7816, 75
7817, 23

Treasury Department Order:
150-95, 510
150-96, 511

Finding List of Current Action on Previously Published Rulings

Delegation Orders:

4 (Rev. 12)
Superseded by
4 (Rev. 13), **331**

5 (Rev. 9)
Superseded by
5 (Rev. 10), **332**

8 (Rev. 7)
Superseded by
8 (Rev. 8), **333**

11 (Rev. 12)
Superseded by
11 (Rev. 13), **333**

14 (Rev. 1)
Superseded by
14 (Rev. 2), **333**

35 (Rev. 11)
Superseded by
35 (Rev. 12), **334**

42 (Rev. 14)
Superseded by
42 (Rev. 15), **334**

42 (Rev. 15)
Superseded by
42 (Rev. 16), **334**

57 (Rev. 4)
Superseded by
57 (Rev. 5), **335**

77 (Rev. 14)
Superseded by
77 (Rev. 15), **335**

88 (Rev. 5)
Superseded by
88 (Rev. 6), **335**

93 (Rev. 7)
Superseded by
93 (Rev. 8), **336**

96 (Rev. 5)
Superseded by
96 (Rev. 6), **336**

97 (Rev. 18)
Superseded by
97 (Rev. 19), **337**

100 (Rev. 2)
Superseded by
100 (Rev. 3), **338**

107 (Rev. 5)
Superseded by
107 (Rev. 6), **339**

109 (Rev. 5)
Superseded by
109 (Rev. 6), **339**

112 (Rev. 6)
Superseded by
112 (Rev. 7), **339**

113 (Rev. 6)
Superseded by
113 (Rev. 7), **340**

114 (Rev. 2)
Superseded by
114 (Rev. 3), **341**

116 (Rev. 4)
Superseded by
116 (Rev. 5), **341**

130 (Rev. 1)
Superseded by
130 (Rev. 2), **341**

Delegation Orders:—Continued

136 (Rev. 3)
Superseded by
136 (Rev. 4), **341**

139 (Rev. 5)
Superseded by
139 (Rev. 6), **342**

143
Superseded by
143 (Rev. 1), **342**

144
Superseded by
144 (Rev. 1), **342**

154
Superseded by
154 (Rev. 1), **342**

155
Superseded by
155 (Rev. 1), **342**

156 (Rev. 1)
Superseded by
156 (Rev. 2), **343**

156 (Rev. 1), Amend 2
Superseded by
156 (Rev. 2), Amend. 1, **349**

156 (Rev. 1), Amend. 3
Superseded by
156 (Rev. 2), **343**

156 (Rev. 2)
Amended by
156 (Rev. 2), Amend. 1, **349**

157 (Rev. 2)
Superseded by
157 (Rev. 3), **350**

160 (Rev. 2)
Superseded by
160 (Rev. 3), **350**

182
Superseded by
182 (Rev. 1), **350**

Revenue Procedures:

64-51
Superseded by
82-19, **463**

70-15
Superseded by
82-19, **463**

70-18
Superseded by
82-29, **481**

72-38
Clarified by
82-6, **409**

74-35
Modified & Superseded by
82-36, **490**

76-14
Superseded by
82-36, **490**

77-37
Amplified by
82-23, **474**

77-39
Superseded by
82-19, **463**

77-47
Obsoleted by
82-24, **474**

Revenue Procedures—Continued

79-10
Obsoleted by
82-34, **489**

79-17
Superseded by
82-5, **406**

79-20
Superseded by
82-13, **447**

79-31
Superseded by
82-29, **481**

79-56
Superseded by
82-7, **410**

80-19
Amplified by
82-17, **462**

80-20
Superseded by
82-37, **491**

80-21
Superseded by
82-38, **503**

80-47
Superseded by
82-3, **368**

80-48
Superseded by
82-4, **380**

81-10
Amplified by
82-8, **413**
82-11, **429**
82-18, **463**
Modified by
82-21, **468**
Superseded by
82-22, **469**

81-13
Superseded by
82-10, **414**

81-33
Superseded in part by
82-37, **491**
Superseded by
82-38, **503**

82-15
Superseded by
82-12, **429**

81-32
Superseded by
82-22, **469**

81-37
Superseded by
82-22, **469**

81-49
Obsoleted by
82-24, **474**

81-50
Superseded by
82-22, **469**

81-61
Superseded by
82-22, **469**

81-64
Superseded by
82-22, **469**

Finding List of Current Action on Previously Published Rulings—Continued

Revenue Procedures—Continued

81-67
Superseded by
82-22, **469**

81-72
Superseded by
82-22, **469**

82-8
Superseded by
82-22, **469**

82-11
Superseded by
82-22, **469**

82-18
Superseded by
82-22, **469**

82-21
Superseded by
82-22, **469**

82-22
Amplified by
82-27, **480**
82-28, **480**
82-30, **485**
82-31, **486**
82-33, **489**
82-35, **489**

Revenue Rulings:

54-27
Obsoleted by
82-127, **215**

54-92
Obsoleted by
82-127, **215**

54-190
Obsoleted by
82-127, **215**

54-343
Amplified by
82-98, **141**

56-375
Superseded by
82-7, **167**

56-616
Obsoleted by
82-114, **104**

58-107
Superseded by
82-31, **166**

58-406
Superseded by
82-60, **63**

59-118
Reinstated by
82-57, **24**

60-248
Modified by
82-56, **17**

63-186
Revoked by
82-52, **168**

63-222
Modified by
82-47, **201**

64-159
Obsoleted by
82-125, **64**

Revenue Rulings—Continued

65-59
Revoked by
82-57, **24**

67-361
Revoked by
82-102, **62**

67-387
Revoked by
82-102, **62**

68-274
Revoked by
82-30, **165**

68-513
Revoked by
82-2, **27**

69-255
Obsoleted by
82-125, **64**

70-291
Amplified by
82-112, **59**

70-459
Revoked by
82-1, **26**

71-209
Distinguished & Clarified by
82-95, **101**

72-191
Distinguished by
82-95, **101**

72-196
Amplified, Clarified, & Superseded by
82-38, **96**

73-612
Amplified by
82-98, **141**

74-161
Distinguished by
82-76, **118**

74-266
Modified by
82-72, **57**

75-457
Amplified by
82-122, **80**

76-545
Clarified by
82-97, **138**

78-110
Amplified by
82-93, **196**

79-16
Superseded by
82-33, **28**

80-22
Amplified by
82-93, **196**

80-157
Amplified by
82-42, **77**

80-300
Amplified by
82-121, **79**

81-86
Clarified by
82-126, **204**

Revenue Rulings—Continued

81-97
Distinguished by
82-7, **167**

81-218
Amplified by
82-42, **77**

81-225
Clarified by
82-55, **12**

Cumulative List of Announcements Relating to Decisions of the Tax Court Published in the Internal Revenue Bulletin from January 1, 1982 thru June 30, 1982

It is the policy of the Internal Revenue Service to announce in the Internal Revenue Bulletin at the earliest practicable date the determination of the Commissioner to acquiesce or not acquiesce in a decision of the Tax Court which disallows a deficiency in tax determined by the Commissioner to be due.

Notice that the Commissioner has acquiesced or nonacquiesced in a decision of the Tax Court relates only to the issue or issues decided adversely to the Government.

Actions of acquiescences in adverse decisions shall be relied on by Revenue officers and others concerned as conclusions of the Service only to the application of the law to the facts in the particular case. Caution should be exercised in extending the application of the decision to a similar case unless the facts and circumstances are substantially the same, and consideration should be given to the effect of new legislation, regulations, and rulings as well as subsequent court decisions and actions thereon.

Acquiescence in a decision means acceptance by the Service of the conclusion reached, and does not necessarily mean acceptance and approval of any or all of the reasons assigned by the court for its conclusions.

No announcements are made in the Bulletin with respect to memorandum opinions of the tax court.

The announcements published in the weekly Internal Revenue Bulletins are consolidated semiannually and annually. The semiannual consolidation appears in the first Bulletin for July and in the Cumulative Bulletin for the first half of the year and the annual consolidation appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner ACQUIESCES in the following decisions:

Taxpayer	Docket No.	*Report* Volume	Page
Brown, Henry M., et ux [1]	12481-81	78	—
Buffalo Tool & Die Manufacturing Co., Inc., Transferor, Peter Hosta, Jr., & Eleanor Hosta, Transferrees [12]	6553-77	74	441
Guest, Winston, F. C., et ux [13]	8844-76	77	9
Lyle, John A., et ux [2]	7663-79	76	668
Mackie, Est. of George C., Kathleen G. Robinson Mackie, executrix [3]	2255-73	64	308
Mattes, Jr., William W.[14]	11475-78	77	650
Meeske, Est. of Fritz L., Hackley Bank & Trust, N.A., executor [4]	9907-74	72	73
Racca, Est. of Luigi, George R. Funaro, executor [5]	2296-79	76	416
Smith, Est. of Charles W., Northern Trust Co., Trustee [4] [6]	9463-74	65	415
Thompson, John D.[15]	4396-77	73	878
Tompkins, Est. of Charles Ray, William A. Tompkins, executor [7]	3098-76	68	912
Westward, Inc.[15]	4397-77	73	878

The Commissioner does NOT ACQUIESCE in the following decisions:

Taxpayer	Docket No.	*Report* Volume	Page
Buffalo Wire Works Co., Inc.[8]	5963-76	74	925
CCA, Inc. (formerly Controls Co. of America, Transferor, an Illinois Corp.) [16]	6524-71	64	137
Canelo III, Adoph, et ux [17]	894-65	53	217
Controls Co. of America (formerly Catherine Corp., Transferee, a Delaware Corp.) [16]	6524-71	64	137
Insilco Corp.[9]	2331-77	73	589
Kane, Jr., Thomas J.[17]	895-65	53	217
Miller, William Field [10]	11722-79	73	1039
Rockefeller, David, et ux [18]	9356-77))		
Rockefeller 3rd, Est. of John D., John D. Rockefeller IV, J. Richardson Dilworth & Donald C. O'Brien, Jr., executors, & Blanchette H. Rockefeller [18]	) 9357-77)	76	178
Singer Co., The, as successor by merger to General Precision Equipment Corp. & Subsidiaries [16]	3628-72	64	137
Wheless, Sr., Est .of William M., W. M. Wheless, Jr., W. M. Powell, Jr., co-independent executors [11]	10100-75	72	470

---

[1] Acquiescence relating to whether the 90 or 150-day statutory period applies to a notice of deficiency addressed to an APO or FPO address, the designation of which appears to be a location "in the United States."

[2] Acquiescence relating to whether petitioners, who moved to follow the husband-petitioner's employment, which he left within 39 weeks, were entitled to moving expense deduction.

[3] Acquiescence relating to whether the bequest of an amount equal to the maximum allowable marital deduction, expressly conditioned on the written acceptance of the bequest within four months of the decedent's death, constitutes a nondeductible terminable interest under section 2056 of the Code.

[4] Acquiescence relating to whether a marital deduction pursuant to section 2056 of the Code is allowable with respect to an "estate equalization clause" which requires valuations of decedent's estate and his surviving spouse's estate as of the alternate valuation date as well as decedent's date of death. See Rev. Rul. 82-23, page 139, this Bulletin.

[5] Acquiescence relating to whether decedent is considered to have survived his wife with respect to jointly held property, for purposes of the marital deduction under section 2056 of the Code, where decedent and his wife died simultaneously and decedent's will provided a presumption of his survival in the event of simultaneous death.

[6] Nonacquiescence published in 1978-2 C.B. 4, is withdrawn and acquiescence substituted therefor. See Rev. Rul. 82-23, page 139, this Bulletin.

[7] Acquiescence relating to whether the surviving spouse's right to elect a cash legacy in lieu of a life estate constitutes a nondeductible terminable interest as defined in section 2056(b)(1) of the Code.

[8] Nonacquiescence in the issues relating to (1) whether the severable portion of a condemnation award, factually agreed upon as reimbursement for moving expenses, constituted an amount realized from the conversion of an asset and is, therefore, eligible for the non-recognition of gain treatment provided by section 1033 of the Code, (2) whether an accrual basis taxpayer is not required to include in income, in the year of recovery, amounts previously deducted, which resulted in tax benefits, and (3) whether moving expenses incurred by an accrual basis taxpayer during the taxable year of 1972 were a deductible business expense in 1972 irrespective of the fact that the taxpayer was reimbursed for said expenses during that year.

[9] Nonacquiescence relating to whether for the year 1971 subsidiary members of the affiliated group, of which petitioner is the parent, are prevented by the conformity requirement of section 472(e)(2) of the Code from using the last-in, first-out (LIFO) method, to reflect their inventories for income tax purposes because the annual consolidated report of the group reflected the inventories of those subsidiaries for that year on a moving-average method.

[10] Nonacquiescence relating to whether petitioner, who is otherwise entitled to an exclusion under section 911(a) of the Code, is limited to one-half of the maximum exclusion because his income is subject to community property laws and his wife was a nonresident alien not subject to United States income tax on her one-half of the petitioner's earned income.

[11] Nonacquiescence relating to whether interest paid by decedent's executors, which had accrued subsequent to decedent's death on debts incurred by decedent and not renewed by the executors, is deductible as an administration expense under section 2053(a)(2) of the Code.

[12] Acquiescence in the issues relating to (1) whether respondent may treat all of the equipment sold by a corporation as a single item of section 1245 property when computing the amount of depreciation recapture, and (2) whether the respondent's reallocation of the sales price of each piece of equipment using subsequent sales prices should be upheld.

[13] Acquiescence relating to whether petitioner made a completed gift of certain parcels of real property to a charity and, if so, what was the amount of the charitable contribution.

[14] Acquiescence relating to whether the expense of a surgical hair transplant, performed by a physician for purely cosmetic reasons, qualifies as a medical expense under section 213 of the Code. See Rev. Rul. 82-111, page 48, this Bulletin.

[15] Acquiescence relating to whether more than 20% of Westward's gross receipts in 1973 and 1974 was "interest" and therefore passive investment income within the meaning of section 1372(e)(5) of the Code, so as to terminate its election under section 1372(a) to be treated as a small business corporation.

[16] Acquiescence published in 1976-2 C.B. 1 in the issue relating to whether Controls, A.G., was a "controlled foreign corporation" within the meaning of section 957(a) of the Code, is withdrawn and nonacquiescence is substituted therefor.

[17] Acquiescence published in 1971-2 C.B. 2 in the issue whether repayments of expenditures made by petitioners on behalf of their clients and deducted, improperly, in the year made are included in petitioner's gross income when received, is withdrawn and nonacquiescence is substituted therefor.

[18] Nonacquiescence relating to whether under section 170(b)(1) of the Code, expenses incurred while rendering services to charitable organizations for which the charities are not legally responsible are contributions "to" rather than merely "for the use of" a charity.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Subpart A.—Income Taxes
Chapter 1.—Normal Taxes and Surtaxes
Subchapter A.—Determination of Tax Liability
Part IV.—Credits Against Tax
Subpart A.—Credits Allowable

Section 38.—Investment In Certain Depreciable Property

26 CFR 1.38-1: Investment in certain depreciable property.

For purposes of section 6655(d)(2) of the Code, relating to the exception to the addition to the tax for a corporation, does an increase in the percentage imposed by section 46(a)(3)(B) of the Code, limiting the amount of the investment credit allowed under section 38 of the Code constitute a change in rates within the meaning of section 1.6655-2(b)(2)(ii) of the regulations? See Rev. Rul. 82-65, page 213.

26 CFR 1.38-1: Investment in certain depreciable property.

Whether property that is a qualifying facility under section 201 of the Public Utility Regulatory Policies Act of 1978 (PURPA) qualifies for the energy credit. See Rev. Rul. 82-109, page 7.

Section 44B.—Credit for Employment of Certain New Employees

May a state employment security agency delegate its certification duties and responsibilities for purposes of the targeted jobs tax credit? See Rev. Rul. 82-8, page 9.

26 CFR 5.44B-1: Credit for employment of certain new employees.

Whether the value of meals and lodging is includible in computing the credit. See Rev. Rul. 82-43, page 10.

Section 44C.—Residential Energy Credit

26 CFR 1.44C-3: Special rules.

Residential energy credit; condominium homeowners association; proper allocation among members. Examples are provided to show how energy conservation expenditures by a condominium association are properly allocated among its members and how, under varying circumstances, the individual members compute the allowable residential energy credit.

Rev. Rul. 82-108

ISSUE

How is the residential energy credit provided for by section 44C of the Internal Revenue Code to be allocated among condominium owners under the circumstances described below?

FACTS

A certain condominium building has five units (construction of which was substantially completed before April 20, 1977) on each of its two stories. The homeowners association of ten members made the following energy conservation expenditures (as defined in section 44C(c) of the Code): $600 in 1978, $6,000 in 1979, and $16,000 in 1980. No energy conservation expenditures with respect to any of the dwelling units were made prior to 1978. Of the expenditures in 1980, $8,000 was for insulation that was placed between the ceiling joists above the five units on the second floor, while the other $8,000 was for insulation that was blown into all exterior walls of the building.

The condominium owners pay identical monthly membership fees to the association. The board of directors of the homeowners association budgets all capital costs and maintenance costs for the common areas each year with a view toward the total membership fees payable for the year from all units without regard to changes in ownership. In each of the three years under consideration here, the energy-conserving components had been installed and paid for from general funds before June 30.

Each of the condominium units is metered separately for utility services and is billed accordingly.

The owner of Unit 3 lived elsewhere during the three years involved, and leased the unit to others. The owner of Unit 8 sold the unit on July 1, 1979, and thus the seller and buyer each used the unit as their principal residence for one-half of the three years. The owners of the other eight units used them as their principal residences for the entire period.

LAW AND ANALYSIS

Section 44C(a) of the Code provides that, in the case of an individual, there shall be allowed as a credit against federal income tax an amount that includes the amount of the taxpayer's "qualified energy conservation expenditures."

Section 44C(b) of the Code provides that, in the case of any dwelling unit, the qualified energy conservation expenditures are 15 percent of any "energy conservation expenditures" of $2000 or less made by the taxpayer with respect to the dwelling unit during the tax year.

Section 44C(c) of the Code provides that energy conservation expenditures are expenditures made by the taxpayer for insulation or any other energy-conserving component installed in or on the dwelling that serves as the taxpayer's principal residence.

Section 44C(b)(4) of the Code provides that no residential energy credit shall be allowed with respect to any return for any tax year if the amount of the credit otherwise allowable is less than $10.

Section 44C(b)(3) of the Code provides that for purposes of determining the credit for expenditures made during a tax year, the taxpayer must reduce the maximum amount of allowable expenditures with respect to the dwelling unit (in computing qualified energy conservation expenditures) by prior expenditures that were made by the taxpayer with respect to the same dwelling unit and that were taken into account in computing the credit for prior years.

Section 1.44C-3(i) of the Income Tax Regulations provides that a condominium owner who belongs to a condominium management association with respect to the unit shall be treated as having made a proportionate share of the energy conservation expenditures of such association. The member's allocable share of those expenditures is the amount that the member is assessed (or would be assessed in the case where expenditures are from general funds) by the association as a result of such expenditures. The credit is allowable for the year in which the association has completed original installation of the item (or has paid or incurred the expenditures, if later).

Section 1.44C-1(d)(2)(ii) of the regulations provides that except in certain cases not applicable here a taxpayer is eligible for the maximum credit notwithstanding the allowance of a credit to a prior owner of the taxpayer's new residence.

Specific questions that arise in allocating the expenditures and the tax credit in this case are: (1) Since the insulation placed in 1980 between the ceiling joists above the top floor units mainly benefits those units only, should the $8,000 cost be allocated among their owners only? (2) Inasmuch as Unit 3's owner, leasing the unit to others, does not use it personally as a principal residence and thus earns no energy credit, is the proper proportionate share of the association's energy conservation expenditures for each of the other nine owners one-ninth of the $22,600 total expenditures? (3) Because Unit 8 changed hands in 1979 after the energy conservation expenditures had been made and the energy property had been installed, is the buyer ineligible for any credit with respect to that unit for that year? (4) If for any tax year the properly allocated share of such expenditures to each member is not sufficient to allow a credit otherwise allowable of $10 or more, may the association take the credit on its own return? (5) If not, and the credit is thus "lost" to all members, must the properly allocated share of expenditures to each member for that year be used to reduce the $2,000 maximum when computing the allowable credit in later years?

In general, the owner of a condominium unit individually owns only the space enclosed by the walls, floor, and ceiling of the unit plus any covering (rugs, paint, paper) of those surfaces. All other space and components of the building are owned, in common, by all the unit owners. In the case under consideration the energy conservation expenditures were made by the association from general funds, and the energy-conserving property was installed in common areas only. The amount each member would have been assessed if all expenditures had been from assessments is one-tenth of the total expenditures. Therefore, under section 1.44C-3(i) of the regulations each member's allocable share of the expenditures is one-tenth thereof.

The five questions posed above are answered as follows:

(1) Although some energy-conserving components (installed in common areas) may benefit some members more than others, the expenditures were made from the association's general funds and therefore under section 1.44C-3(i) of the regulations each of the ten members is treated as having made a proportionate share of such expenditures.

(2) The association's expenditures for each tax year are allocated among all ten member-owners without regard to whether any member's allocated share is qualified energy conservation expenditures. In 1978, for instance, the $600 allocated equally among all ten member-owners means $60 in energy conservation expenditures to each. Fifteen percent of the $60 is $9, which would be the qualified energy conservation expenditures by nine of the members if it were not for the $10 minimum that is set by section 44C (b)(4) of the Code. Even if the allocation were $10 or more to each member, the non-resident owner of Unit 3, under section 44C(c), could not treat the allocated amount as qualified energy conservation expenditures.

(3) Under section 44C of the Code the credit is allowable to an owner of a dwelling unit and is earned by certain expenditures made with respect to the unit in the tax year, and under section 1.44C-3(i) of the regulations a condominium unit owner's share of the credit depends on the amount the owner would be assessed on account of the expenditures. Because the expenditures in this case were from general funds that are made up by monthly membership fees (general assessments), the buyer of Unit 8 will have paid Unit 8's allocated portion of the costs of the energy-conserving components to the extent of six monthly payments. That is, the buyer's payments from July 1 to December 31, 1979, into the general fund would include Unit 8's portion of the qualified energy conservation expenditures for that period. The buyer of Unit 8 is allocated $300 of the association's expenditures for 1979 and is eligible for the credit based on an expenditure of this amount.

(4) The association cannot be allowed the energy tax credit in tax years in which the members do not meet the $10 minimum because section 44C of the Code provides that the credit is allowable only to an individual.

(5) In determining whether the $2000 limitation is reached in any tax year, no unit owner has to take into account the expenditures allocated to the unit in an earlier year in which the credit was disallowed on account of the $10 minimum, because the allocated expenditures in the earlier year were not taken into account in computing the credit for the prior year within the meaning of section 44C (b)(3) of the Code. In the case under consideration, $600 was spent by the association in 1978 but no part of it was taken into account in computing tax credits and therefore no reduction of anyone's $2000 maximum is required in making the tax credit determinations for 1979. In 1980, however, the eight taxpayers who have been owner-residents since 1978 must each reduce their $2000 maximum by the $600 allocated to and used by them in 1979, which gives $1,400 as the maximum usable by them in 1980. The purchaser of Unit 8, who used only $300 in 1979, has a $1,700 ceiling in 1980 and can thus use the entire $1,600 allocated to the unit.

HOLDING

The foregoing principles applied to the condominium situation described above results in the following allocation of expenditures by the association and allowable energy tax credit by the owners:

	Amount
1978	
Energy conservation expenditures by association	$600
Energy conservation expenditures allocable to each unit, ($600/10)	60
Qualified energy conservation expenditures by owner, Unit 3, (non-resident)	0
Tentative qualified energy conservation expenditures, other nine owners, ($60 x 0.15)	9
Qualified energy conservation expenditures allowable, other nine owners, ($10 minimum)	0
1979	
Energy conservation expenditures by association	$6,000
Energy conservation expenditures allocable to each unit, ($6,000/10)	600
Qualified energy conservation expenditures by seller, Unit 8, ($600 x ½ yr x 0.15)	45
Qualified energy conservation expenditures by buyer, Unit 8, ($600 x ½ yr x 0.15)	45
Qualified energy conservation expenditures by other eight owner-residents, ($600 x 0.15)	90
1980	
Energy conservation expenditures by association	$16,000
Energy conservation expenditures allocable to each owner, ($16,000/10)	1,600
Qualified energy conservation expenditures by owner, Unit 8, ($1600 x 0.15)	240
Qualified energy conservation expenditures by other eight owner-residents, ($1400 x 0.15)	210

Subpart B.—Rules for Computing Credit for Investment in Certain Depreciable Property

Section 46.—Amount of Credit

26 CFR 1.46-1: Determination of amount.

For purposes of section 6655(d)(2) of the Code, relating to the exception to the addition to the tax for a corporation, does an increase in the percentage imposed by section 46(a)(3)(B) of the Code, limiting the amount of the investment credit allowed under section 38 of the Code constitute a change in rates within the meaning of section 1.6655-2(b)(2)(ii) of the regulations? See Rev. Rul. 82-65, page 213.

---

26 CFR 1.46-2: Carryback and carryover of unused credit.
(Also Section 6511; 301.6511(b)-1.)

Investment credit; unclaimed in closed year; carryover. The failure to claim investment tax credit on qualified section 38 property placed in service in a year for which the period of limitations for filing a claim for credit or refund has expired under section 6511 of the Code does not prevent any "unused credit" from the closed year being carried over to an open year under section 46(b).

Rev. Rul. 82-49

ISSUE

Must the investment tax credit on qualified section 38 property have been claimed by a taxpayer on an income tax return, or in a timely claim for refund for the year the property was placed in service before the investment tax credit can be carried over under section 46(b) of the Internal Revenue Code to a succeeding tax year?

FACTS

The taxpayer, a corporation, was formed in 1976. In that year it placed in service "section 38 property" that qualified for an investment tax credit of 100x dollars. Through an error on the part of the taxpayer, it failed to claim the investment tax credit on its income tax return for the calendar year 1976, which was filed on March 15, 1977. As a result, the taxpayer paid a tax of 40x dollars for 1976. The 40x dollars of tax liability was less than the limitation on the credit provided under section 46(a)(3) of the Code.

In each of the years 1977 through 1979 the taxpayer had a tax liability of 20x dollars. In June 1980 the taxpayer discovered its failure to claim the investment tax credit on the "section 38 property" placed in service in 1976. However, the taxpayer was barred by section 6511 of the Code from claiming a credit or refund for the tax year 1976.

Taxpayer seeks to use the investment tax credit of 100x dollars that it failed to claim in a year now closed to generate an investment tax credit carryover to 1977, 1978, and 1979.

LAW AND ANALYSIS

Section 46(a)(3) of the Code provides that the credit allowed by section 38 for a tax year will not exceed so much of the liability for tax for the tax year as does not exceed $25,000 plus a percentage of the liability for tax for the tax year as exceeds $25,000.

Section 46(b) of the Code provides that unused investment tax credits may be carried back 3 tax years and forward 15 tax years from the "unused credit year." Section 46(b) further provides that if the carryover and credit earned for a year exceed the applicable tax limitation under section 46(a)(3), the excess attributable to the credit earned is an "unused credit."

Section 6511(a) of the Code provides that a claim for credit or refund of an overpayment of any tax must be filed by the taxpayer within 3 years from the time the return was filed or 2 years from the time the tax was paid, whichever of such periods expires the later.

Rev. Rul. 69-543, 1969-2 C.B. 1, holds that assessment and collection of deficiencies resulting from the disallowance of investment credit carryovers can be made even though assessment for the year in which the investment credit was incorrectly claimed is barred by section 6501(a) of the Code. *See Mennuto v. Commissioner*, 56 T.C. 910 (1971), *acq.*, 1973-2 C.B. 2.

A similar rule applies to claims for refund filed by a taxpayer. In Rev. Rul. 81-88, 1981-1 C.B. 585, the Service discussed an analogous issue. In *Situation 2* of that revenue ruling, a taxpayer failed to take a deduction of 220x dollars in a barred year in which the taxpayer had shown taxable income on its return (without regard to the deduction) of 100x dollars. The Service concluded that, while the taxpayer could not receive a refund for the barred year, the taxpayer could use the barred deduction to generate a net operating loss carryover of 120x dollars. The rules for carryovers of investment tax credits and net operating losses operate in the same manner. Thus, while section 6511 of the Code bars refunds for years in which the period of limitations for claiming the refund has expired, it does not bar the making of a claim for refund based on a carryover of investment tax credit under section 46(b) to an open year. Here, the period of limitations for making claims for refund for 1977, 1978, and 1979 has not expired.

HOLDING

The investment tax credit on qualified section 38 property need not have been claimed on an income tax return, or in a timely claim for refund for the year the property was placed in service, before the investment tax credit can be carried over under section 46(b) of the Code to an open year.

Taxpayer is entitled to claim an investment tax credit carryover of 20x dollars each year for 1977, 1978, and 1979 as a result of the investment tax credit carryover from 1976 of 60x dollars (investment tax credit of 100x dollars less the 40x dollars of credit that would have extinguished the taxpayer's 40x dollars of tax liability on its 1976 income tax return and that does not constitute an "unused credit" under section 46(b) of the Code).

26 CFR 1.46-4: Limitations with respect to certain persons.

Investment credit; noncorporate lessors; limitations. The requirement of section 46(e)(3)(B) of the Code that a noncorporate lessor's expenses must exceed 15 percent of the rental income during the first 12 months after the property is transferred to the lessee applies when a lease term is less than 12 months.

Rev. Rul. 82-50

ISSUE

For purposes of the investment tax credit, does the requirement of section 46(e)(3)(B) of the Internal Revenue Code that a noncorporate lessor's expenses must exceed 15 percent of the rental income during the first 12 months after the property is transferred to the lessee apply when a lease term is less than 12 months?

FACTS

The taxpayer, a noncorporate lessor, owned a machine that it leased to an individual for 2 years, with a renewal term of an additional 2 years. The machine has an estimated useful life of 9 years. Approximately 9 months after the property was transferred to the lessee, the lease was terminated by mutual agreement between the parties, and the property was not released during the next 3 months.

LAW AND ANALYSIS

Section 46(e)(3)(B) of the Code states that a noncorporate lessor is allowed a credit by section 38 if, for the period consisting of the 12 months after the date on which the property is transferred to the lessee, the sum of deductions allowable to the lessor by section 162 (with certain exceptions) exceeds 15 percent of the rental income produced by such property, and the term of the lease (taking into account options to renew) is less than 50 percent of the useful life of the property. The lease term in this case meets the requirement of the statute.

Section 46(e)(3)(B) of the Code states that the more-than-15 percent test is to be applied to a 12 month *period*. There is no requirement that the term of the lease or the period during which the property is actually leased must cover the entire 12 month period. The purpose of the 15 percent test is to ensure that a lessor is actively engaged in the leasing business, rather than a financing transaction, before the credit is allowed. H.R. Rep. No. 92-533, 92d Cong., 1st Sess. 29 (1971), 1972-1 C.B. 498, 513; S. Rep. No. 92-437, 92d Cong., 1st Sess. 44 (1971), 1972-1 C.B. 559, 583. If a lessor incurs expenses exceeding 15 percent of the rental income produced by the property for such items as maintenance, insurance premiums, and salaries, it can fairly be said that the lessor is actively engaged in the leasing business under the Code. The 15 percent test is equally necessary whether the lease term or the period during which the property is actually leased is more or less than 12 months. Consequently the requirement of section 46(e)(3)(B) would be met if the lessor's enumerated section 162 deductions exceeded 15 percent of the rent produced by the property for the 9 months, but would not be met if such expenses equaled only 15 percent or less of the rent produced.

HOLDING

The requirement of section 46(e)(3)(B) of the Code that a noncorporate lessor's expenses must exceed 15 percent of the rental income from the property for the first 12 months after the property is transferred to the lessee does apply when a lease term is less than 12 months.

Section 47.—Certain Dispositions, etc., of Section 38 Property

26 CFR 1.47-1: Recomputation of credit allowed by section 38.

Whether there is a disposition under section 47(a)(1) of the Code when section 38 property is transferred by a member of an affiliated group that files consolidated returns and the transfer is part of a transaction that qualifies as a "split-off" under sections 355(a)(1) and 368(a)(1)(D). See Rev. Rul. 82-20, below.

---

26 CFR 1.47-3: Exceptions to the application of section 1.47-1.
(Also Sections 355, 368, 1502; 1.47-1, 1.355-1, 1.368-1, 1.1502-3.)

Investment credit; recapture; transfer of property in reorganization. The transfer of section 38 property between members of a consolidated group in a consolidated return year constitutes a disposition of section 38 property under section 47(a)(1) of the Code when the transfer is part of a plan to transfer the section 38 property outside the consolidated group in a transaction

qualifying as a reorganization under sections 355(a)(1) and 368(a)(1)(D).

Rev. Rul. 82-20

ISSUE

Is there a disposition under section 47(a)(1) of the Internal Revenue Code when section 38 property is transferred by a member of an affiliated group that files consolidated returns and the transfer is part of a transaction that qualifies as a "split-off" under section 355(a)(1) and 368(a)(1)(D)?

FACTS

P corporation, whose stock is equally owned by *A* and *B*, has been actively engaged in two separate businesses for more than 5 years. *P* also owns 100 percent of the stock of *S* corporation. *S* has also been actively engaged in business for more than 5 years. *P* and *S* both use the accrual method of accounting and file a consolidated federal income tax return on a calendar year basis.

Because of conflicting opinions between *A* and *B* on the expansion and administration of *P*, it was decided that one of the businesses of *P* and the stock of *S* should be transferred to *A*. Under the plan, *P* transferred all the assets of one of the businesses necessary to conduct the trade or business, including section 38 property, to *S* solely in exchange for additional shares in *S* and immediately thereafter distributed all the stock of *S* to *A*. *S* will continue to use the assets in the same trade or business. The transaction qualified under section 355(a)(1) and 368(a)(1)(D) of the Code. *A* surrendered all its stock in *P* as part of the transaction.

LAW AND ANALYSIS

Section 47(a)(1) of the Code provides that if any property is disposed of, or otherwise ceases to be section 38 property with respect to a taxpayer, before the close of the useful life on which the credit under section 38 was computed, federal income tax will be adjusted for the tax year in which the disposition or cessation took place. *See* section 1.47-1(a) of the Income Tax Regulations.

Section 47(b) of the Code provides exceptions to the disposition provisions of section 47(a). If the transaction involves a mere change in the form of conducting the trade or business, the property will not be treated as ceasing to be section 38 property with respect to the taxpayer so long as the property is retained in that trade or business as section 38 property and the taxpayer retains a substantial interest in the trade or business.

Section 1.47-3(f)(1)(i) of the regulations provides that section 1.47-1(a) does not apply to section 38 property that is disposed of or otherwise ceases to be section 38 property with respect to the taxpayer by reason of a mere change in the form of conducting the trade or business in which the section 38 property is used, provided the conditions set forth in section 1.47-3(f)(1)(ii) are satisfied.

Section 1.47-3(f)(5)(ii) of the regulations provides that if in any tax year the transferor of section 38 property described in section 1.47-3(f)(1)(i) does not retain, either directly or indirectly, a substantial interest in the trade or business, as defined in section 1.47-3(f)(2), then, under section 1.47-1(a), the property ceases to be section 38 property with respect to the transferor and the taxpayer must make a recapture determination.

Section 1.1502-3(f)(2)(i) of the regulations provides that a transfer of section 38 property from one member of a consolidated group to another member of the group during a consolidated return year shall not be treated as a disposition or cessation within the meaning of section 47(a)(1) of the Code.

Rev. Rul. 74-101, 1974-1 C.B. 7, provides that section 47(a)(1) of the Code applies when a corporation engaged in the same business in three states transfers its business activities in two of the states and all related assets, including section 38 property, to two newly formed corporations solely in exchange for all their stock and immediately thereafter transfers the stock to its sole shareholder in a section 368(a)(1)(D) reorganization.

The issue in Rev. Rul. 74-101 is similar to that described here with one exception. In the present case *P* and *S* are members of a consolidated group that files a consolidated return in the year of transfer. Thus, the specific question is whether the fact that a consolidated group is involved in the transfer should result in a different holding from that in Rev. Rul. 74-101.

The transfer of section 38 property between *P* and *S* constitutes a disposition under section 47(a)(1) of the Code. Although section 1.1502-3(f)(2)(i) of the regulations creates an exception for transfers of section 38 property between members of a consolidated group that would otherwise be dispositions under section 47(a)(1), the exception is premised on the assumption that the property is remaining within the consolidated group. When there is no intention at the time of transfer to keep the property within the consolidated group, the transaction should be viewed as a whole and not as separate individual transactions. *Compare Helvering v. Bashford*, 302 U.S. 454 (1938), Ct. D. 1299, 1938-1 C.B. 286, and Rev. Rul. 70-140, 1970-1 C.B. 73.

In the present case, the transfer of the section 38 propety from *P* to *S* is part of a transaction in which *S* is split off from the group. Because the transfer from *P* to *S* is a step in the planned transfer of the property outside the group, section 1.1502-3(f)(2)(i) of the regulations does not apply.

HOLDING

Because the transfer of the section 38 property from *P* to *S* is a step in the planned transfer of the property outside the group, the exception in section 1.1502-3(f)(2)(i) of the regulations does not apply to this transaction. Therefore, the transfer from *P* to *S* is a disposition under section 47(a)(1) of the Code.

Section 48.—Definitions; Special Rules

26 CFR 1.48-1: Definition of section 38 property.
(Also Section 38; 1.38-1.)

Energy credit; Public Utility Regulatory Policies Act of 1978 (PURPA);

qualifying facility. Property that is a qualifying facility under section 201 of PURPA is not public utility property under section 48(l)(17) of the Code if the rates charged are not determined on a rate-of-return basis. Therefore, such property may be energy property under section 48(l).

Rev. Rul. 82-109

ISSUE

May property that is a "qualifying facility" within the meaning of section 201 of the Public Utility Regulatory Policies Act of 1978 (PURPA) also be energy property within the meaning of section 48(l) of the Internal Revenue Code?

LAW AND ANALYSIS

The question occurs because section 48(l)(17) of the Code excludes public utility property from the term "energy property" in certain cases. A crucial issue therefore becomes whether a qualifying facility under section 201 of PURPA also is public utility property under section 48(l)(17) of the Code. If this is so, the property cannot qualify as energy property. However, if qualifying facilities are not public utility property, then a qualifying facility under PURPA also may be energy property under section 48(l) of the Code.

Section 210(a)(2) of PURPA requires electric utilities to purchase available electric energy from cogeneration and small power production facilities that are qualifying facilities under section 201 of PURPA. Cogeneration facilities simultaneously produce two forms of useful energy, such as electric power and steam. Small power production facilities use biomass, waste, or renewable resources to produce electric power. Under section 201 of PURPA, cogeneration facilities and small power production facilities that meet certain standards and that are not owned by persons primarily engaged in the generation or sale of electric power can become qualifying facilities.

Section 46(a) of the Code provides that the investment tax credit shall include an amount equal to the energy percentage of the qualified investment in energy property. However, as previously stated, energy property does not include public utility property in certain cases. For purposes of section 48(l)(17) public utility property used for the generation of electricity means property used predominantly in the trade or business of the furnishing or sale of electricity for which the rates are regulated by a federal or state governmental body. See Section 46(c)(3)(B). Section 1.46-3(g)(2)(iii) of the Income Tax Regulations provides that a taxpayer's rates are regulated if they are established or approved on a rate-of-return basis; that is, the rates cover the taxpayer's cost of providing goods or services, including a fair return on the taxpayer's investment in providing such goods or services, where the taxpayer's costs and investments are determined by the use of a uniform system of accounts prescribed by the regulatory body.

The Conference Report accompanying PURPA, H. Rep. No. 1750, 97, 95th Cong. 2d Sess. (1978) noted:

> It is not the intention of the conferees that cogenerators and small power producers become subject. . .to the type of examination that is traditionally given to electric utility rate applications to determine what is the just and reasonable rate that they should receive for their electric power.

Further, section 210(b) of PURPA provides that the purchase rates paid by electric utilities to qualifying facilities for electric energy shall be just and reasonable to consumers, shall not discriminate against qualifying facilities, and shall not exceed the *incremental cost to utilities* of alternative electric energy.

Under PURPA, the prices utilities may be required to pay for the electric energy purchased from qualifying facilities are based on the costs that the utilities would have incurred for alternative energy and not on the costs incurred by the qualifying facility. Consequently, these prices are not established on a rate-of-return basis within the meaning of section 1.46-3(g)(2)(iii) of the regulations.

HOLDING

Property that is a qualifying facility under Section 201 of PURPA is not public utility property under section 48(l)(17) of the Code if the rates charged are not determined on a rate-of-return basis. Therefore, such property may be energy property under section 48(l) of the Code.

---

26 CFR 1.48-8: Motion picture and television films and tapes.

Investment credit; master video tapes. A limited partnership purchased master video tapes to produce video cassettes and video discs on topics involving critical care medicine. As the master video tapes are created principally for ultimate use by private individuals in their own training and development, the master tapes are not "qualified films" for purposes of the investment credit.

Rev. Rul. 82-79

ISSUE

Is the investment tax credit available with respect to an investment in master video tapes, under the circumstances described below?

FACTS

In 1980 *X* offers to sell 35 units of a limited partnership, *P*, in which *X* is the general partner. Each unit represents a 2.82 percent interest in *P*'s profits and losses and can be purchased for 28*x* dollars, one-half payable in 1980 and one-half in 1981. *X*, as general partner, will acquire a 1.3 percent interest in *P*'s profits and losses for a nominal consideration.

According to the promotional materials, *P* will purchase all rights, including the copyright and distribution rights, to 20 master video tapes placed in service in 1980. The subject of each master is a topic in the field of critical care medicine. *P* will have video cassettes and video discs reproduced from the masters and marketed to practicing physicians, allied health personnel, hospitals, medical groups, technicians, and other interested parties. *P* will purchase each master for 760*x* dollars by making a cash downpayment of 37*x* dollars and executing a nonrecourse note for 723*x* dollars. The notes are due and payable, together with interest, in 1990, and prepayments are required only to the extent of 35 percent of the partnership's gross sales or other income.

In the promotional materials, *X* represents that an investment tax credit of 1520*x* dollars (760*x* dollars per master times 20 master times 10 percent) will be available with respect to the masters and that each partner will be entitled to a distributive share of that amount. *X* represents that section 48(k) of the Internal Revenue Code is not applicable to this type of property and that, therefore, the regular investment tax credit provisions apply.

LAW AND ANALYSIS

Section 48(k)(1)(A) of the Code provides that an investment credit is allowable to a taxpayer with respect to any motion picture film or video tape only if the film or tape is new section 38 property that is a qualified film and only to the extent that the taxpayer has an ownership interest in the film or tape.

A qualified film is defined in section 48(k)(1)(B) of the Code as any motion picture film or video tape created primarily for use as public entertainment or for educational purposes. Section 1.48-8(a)(3) of the Income Tax Regulations provides that a film or tape is created primarily for educational purposes if it is created principally for use by educational institutions or governmental units such as primary or secondary schools, colleges and universities, vocational and post-secondary educational institutions, public libraries, or other governmental agencies. Films and tapes created primarily for use by industrial or commercial organizations do not qualify for the credit. Thus, advertisements and industrial training films and tapes do not qualify for the credit.

In the present situation, the master video tapes are used to produce video cassettes and video discs on topics involving critical care medicine. The master video tapes are created principally for ultimate use by private individuals in their own training and development. The master video tapes are not created principally for use by educational institutions or governmental units and therefore, the master video tapes do not come within the definition of a qualified film as being a film or tape created primarily for educational purposes. Because the master video tapes are not qualified film for purposes of section 48(k)(1)(B), no investment tax credit may be claimed with regard to them.

HOLDING

No investment tax credit is available with respect to these master video tapes on educational topics because they are not qualified films within the meaning of section 48(k)(1)(B) of the Code.

Subpart D.—Rules for Computing Credit for Employment of Certain New Employees

Section 51.—Amount of Credit

(Also Section 44B.)

Targeted jobs credit; state employment security agency; delegation of certification. A state employment security agency may not delegate its certification duties and responsibilities under the targeted jobs credit to other agencies or organizations.

Rev. Rul. 82-8 [1]

ISSUE

For purposes of the targeted jobs credit, may a state employment security agency (SESA) delegate its certification duties and responsibilities?

FACTS

A SESA, which is the "designated local agency" for purposes of the targeted jobs credit, encountered budgetary problems and as a result was forced to severely reduce its workforce. Consequently, it desires to delegate its certification responsibilities to other agencies and organizations. These proposed delegated responsibilities include the authority to certify that an individual is a qualified member of a targeted group and in the case of a "youth participating in a cooperative education program," the authority to determine whether the student is a member of an economically disadvantaged family.

LAW AND ANALYSIS

Section 51(d)(1) of the Code lists nine targeted groups whose members have difficulty finding employment. If an employer hires an individual who is certified as a member of one of these groups, the employer may elect to claim the targeted jobs credit under section 44B on the wages paid or incurred to that employee. For eight of the targeted groups, an individual can qualify as a member of a targeted group only if that individual is certified by a designated local agency as meeting specified requirements for that group. The only exception is provided by section 51(d)(8), which specifies that for purposes of certifying an individual as a youth participating in a qualified cooperative education program (cooperative education student), the certification is done by the school participating in the program.

Four of the targeted groups have the requirement that the individual must be a member of an economically disadvantaged family. Section 51(d)(11) of the Code sets out the criteria for this determination and provides that the determination is to be made by a designated local agency.

Prior to the Economic Recovery Tax Act of 1981 (ERTA), Pub. L. 97-34, 1981-2 C.B. 256, section 51(d)(12) of the Code gave the Secretary of Labor and the Secretary of the Treasury joint authority to designate the agency to perform certifications of employees in a particular locality. The ERTA redesignated section 51(d)(12) as section 51(d)(14), 1981-2 C.B. 303, and amended that section to provide that the term "designated local agency" means a SESA established in accordance with the Act of June 6, 1933, as amended (29 U.S.C. sections 49-49n (1976)). 1981-2 C.B. 304.

Congress indicated that it was designating the SESA in each state as the agency responsible for administering the certification process, in order to alter "[t]he diffusion of responsibility among several agencies in the past few years [that] has limited employer participation." H.R. Rep. No. 97-201,

---

[1] Also released a News Release IR-81-139, dated December 21, 1981.

97th Cong., 1st Sess. 279, 1981-2 C.B. 352, 409.

Section 51(d)(14) of the Code states specifically that the designated local agency is the SESA. Therefore, the statute allows only the SESA to be the certifying agency for purposes of the targeted jobs credit with respect to all targeted groups other than cooperative education students. The legislative history shows that it was the intent of Congress that the SESA in each state would be responsible for administering the certification process. There is no authority in the statute, nor support in the legislative history, that permits a SESA to delegate its targeted jobs credit responsibilities to make the final certification to other agencies or organizations.

The targeted jobs credit may be claimed on wages paid to a properly certified individual. For individuals (other than cooperative education students), the certification must be issued by the SESA in order to be valid. If an employer receives a certification from an agency not authorized by the statute to make certifications, the certification is invalid and the employer may not elect a targeted jobs credit on wages paid to that individual.

Although the statute precludes a SESA from delegating its certification authority to other agencies or organizations, there is nothing that prohibits a SESA from soliciting advice and assistance from other agencies and organizations. As an example of such assistance, some SESAs have entered into written agreements with other agencies and organizations in which the other agencies and organizations make the preliminary determination of eligibility (vouchering). The preliminary eligibility determination is not a certification. H. R. Rep. No. 97-201, 1981-2 C.B. 352, 409, states "The committee intends that other agencies involved in providing information for certification, such as the Social Security Administration (for SSI recipients) and the Veterans' Administration (for handicapped and Vietnam-era veterans), will fully cooperate with the State employment security agencies requests for assistance in administering the certification process."

With respect to a cooperative education student, the school participating in the program makes the certification. However, the determination whether the student is a member of an economically disadvantaged family is made by the SESA. The school may assist the SESA in this determination, but the school cannot make the final determination for the SESA.

HOLDING

A SESA may not delegate its certification duties and responsibilities under the targeted jobs credit to other agencies or organizations. However, a SESA may use the expertise of other agencies and organizations to provide the information necessary to assist it in performing its certification duties and responsibilities.

(Also Sections 44B, 280C; 1.44B-1, 1.280C-1.)

Targeted and new jobs credit; meals and lodging excludable from employee's gross income. Employers may not use the value of meals and lodging that is excludable from an employee's gross income under section 119 of the Code in computing the amount of either the targeted jobs tax credit or the new jobs tax credit. Employers need not reduce their wage and salary expense deductions by the value of such meals and lodging.

Rev. Rul. 82-43

ISSUE

May employers use the value of meals and lodging furnished for the convenience of the employer that is excludable from an employee's gross income under section 119 of the Internal Revenue Code in computing the targeted jobs tax credit or the new jobs tax credit under section 51?

LAW AND ANALYSIS

Section 44B of the Code allows a targeted jobs tax credit to employers. It replaced the new jobs tax credit, which expired December 31, 1978. The amount of both credits is determined under sections 51 through 53.

Under section 51 of the Code, both the targeted jobs tax credit and the new jobs tax credit depend, in general, on the amount of "wages" under section 3306(b) of the Code.

Rev. Rul. 81-222, 1981-2 C.B. 205, states that in light of the decision of the Supreme Court of the United States in *Rowan Companies, Inc. v. United States*, 101 S. Ct. 2288 (1981), Ct. D. 2009, 1981-2 C.B. 191, the value of meals and lodging furnished for the convenience of the employer that is excludable from an employee's gross income under section 119 of the Code is not wages under section 3306(b).

Section 280C of the Code, which applies to both the new jobs tax credit and the targeted jobs tax credit, provides that no deduction is allowed for that portion of the wages paid or incurred for the tax year that is equal to the amount of the credit allowable for the tax year under section 44B.

HOLDING

Employers may not use the value of meals and lodging that is excludable from an employee's gross income under section 119 of the Code in computing the amount of either the targeted jobs tax credit or the new jobs tax credit because these amounts are not wages under section 3306(b). If employers have used the value of such meals and lodging in computing either credit, they should file amended income tax returns and recompute their credit. However, employers need not reduce their wage and salary expense deductions by the value of such meals and lodging.

Part VI.—Minimum Tax for Tax Preferences

Section 57.—Items of Tax Preference

26 CFR 1.57-1: Items of tax preference defined.

Whether the selection of any asset depreciation period under 1.167(a)-11 (CLADR system) may be changed to increase the guideline life in order to eliminate the tax preference item that results from the 20% "bonus depreciation." See Rev. Rul. 82-22, page 33.

Subchapter B.—Computation of Taxable Income
Part I.—Definition of Gross Income, Adjusted Gross Income, Taxable Income, etc.

Section 61.—Gross Income Defined

26 CFR 1.61-1: Gross income.

Advance payments; security deposits; coupon clearinghouse. Amounts received by a coupon clearinghouse as security deposits from its retail merchant clients to cover losses from invalid coupons submitted by the merchants are not includible in gross income under section 61 of the Code.

Rev. Rul. 82-28

ISSUE

Are amounts received by the taxpayer as security deposits to cover losses because of invalid coupons included in the taxpayer's gross income under section 61 of the Internal Revenue Code?

FACTS

X, a domestic corporation, is a clearinghouse for the redemption of merchandising coupons. *X*'s clients are retailers that accept merchandising coupons from their customers and manufacturers that issue the coupons to encourage the sale of their products.

Under agreements with its retail clients, *X* is authorized to act as an agent to redeem coupons on their behalf. *X* must reimburse the retailers for all valid coupons submitted to *X* and redeemed by the issuing manufacturer. After sorting and counting the coupons, but before the manufacturers have redeemed them, *X* pays the retailer the redemption value of all coupons submitted, less a service fee.

It is impractical and sometimes impossible for *X* to determine if all the coupons it receives are valid. Because *X* is required to reimburse its retail clients only for valid coupons, each retail client is required to maintain a security deposit with *X* to protect *X* against losses arising from invalid coupons. If a manufacturer determines that a coupon is invalid and does not reimburse *X* for the coupon, *X* charges the security deposit account of the retail client that submitted the coupon for an amount equal to the value of the coupon. The retailer agreement does not authorize *X* to make any other charges against the security deposit. Although separate records of each security deposit are maintained by *X*, the deposits are not segregated from *X*'s general funds and *X* has unrestricted, interest-free use of the funds. When a retailer agreement is terminated, the balance of security deposits remaining is returned to the retailer.

LAW AND ANALYSIS

Section 61(a) of the Code provides that gross income means all income from whatever source derived.

Rev. Rul. 72-519, 1972-2 C.B. 32, sets forth two factual situations involving the treatment of security deposits. Situation (1) of Rev. Rul. 72-519, which involves deposits on fuel sold under a "meter purchase plan," holds that if the purpose of a deposit is to protect a taxpayer's interest in property and not to secure payment of income, the deposit is treated as a true security deposit and is not includible in gross income. Situation (2) of Rev. Rul. 72-519, which involves deposits made by customers of a water company, holds that if a deposit is received as security for the payment of amounts to be paid for goods, the deposit will be treated as an advance payment for the goods and is included in the recipient's gross income.

In the present situation, the security deposits maintained by *X* are not advance payments because they are not received as security for the payment of amounts due *X* for providing its services. *X* receives a fee for its services at the time coupons are submitted to *X* by retailers and *X* does not look to the security deposits to get its fees. In addition, under the retailer agreements, *X* is not authorized to charge the security deposits for anything other than losses from invalid coupons. Thus, as in Situation (1) of Rev. Rul. 72-519, the purpose of the security deposits is to protect *X*'s interest in property, that is, its own funds which must be used to cover losses from invalid coupons, and not to secure the receipt of income.

HOLDING

Amounts received by *X* as security deposits to cover losses because of invalid coupons are not included in *X*'s gross income under section 61 of the Code.

* * *

26 CFR 1.61-1: Gross income.
(Also Sections 72, 403, 408, 801; 1.72-1, 1.403(a)-1, 1.403(b)-1, 1.408-3, 1.801-8.)

Gross income; mutual fund; annuity contracts. An insurance company has funded its annuity contracts through a variable annuity fund. The assets of the fund are invested in three mutual funds the shares of which are not sold to the general public. The policyholders may direct their annuity purchase payments to be invested in shares of any or all of the three mutual funds. The insurer, and not the policyholder, is the owner of the mutual fund shares for federal income tax purposes.

Rev. Rul. 82-54 [1]

ISSUE

Will the life insurance company or the policyholder be considered the owner, for federal income tax purposes, of the mutual fund shares under the circumstances described below?

FACTS

The terms "variable payment deferred annuity", "fixed payment deferred annuity", and "policyholder", as used in this revenue ruling, are for descriptive convenience only and are not intended to have substantive legal significance.

IC is a life insurance company taxable under section 802 of the Internal Revenue Code. In states where it is authorized to do so, *IC* issues contracts which it describes as variable payment deferred annuity contracts and fixed payments deferred annuity contracts ("the Contracts").

---

[1] Also released as News Release IR-82-38, dated March 18, 1982.

Under the terms of the Contracts a policyholder will receive either variable monthly annuity or fixed monthly annuity benefits as of a selected maturity date. The policyholder may pay the purchase price of either of these contracts by a single payment or through a series of periodic payments.

The Contracts are funded through a variable annuity fund ("the Fund") that is organized pursuant to state law as a separate (segregated asset) account of *IC* and is registered as a "unit investment trust" under the Investment Company Act of 1940, as amended. *IC* performs all sales and administrative functions relating to the Fund and to the Contracts.

IC has represented to policyholders that assets of the Fund will be invested, as the policyholder directs, in shares of any or all of three open-end diversified management investment companies ("Mutual Funds"). Each of the Mutual Funds offers a different general investment strategy. One Mutual Fund invests primarily in common stock, another in bonds, and the third in money market instruments. A policyholder is free to allocate his purchase payments among the three Mutual Funds. Allocations made with respect to previous purchase payments may be changed by a policyholder at any time prior to the contract's maturity date.

IC serves as investment manager for each of the Mutual Funds. Shares of the Mutual Funds are not available to the general public but are available only to the Fund and to other segregated asset accounts (except investment plan accounts of the type described in Rev. Rul. 70-525, 1970-2 C.B. 144) established by *IC*. However, *IC* has retained the right to substitute the shares of any other mutual fund for the shares initially held.

LAW AND ANALYSIS

Section 61(a) of the Internal Revenue Code provides that gross income means all income from whatever source derived, including interest and dividends.

Rev. Rul. 77-85, 1977-1 C.B. 12, holds that the purchaser of an "investment" annuity contract, by means of which the purchaser individually selected and controlled one or more investments in a portfolio comprising a separate account of the life insurance company issuing the contract, is considered the owner of the underlying investments for federal income tax purposes. Similarly, Rev. Rul. 80-274, 1980-2 C.B. 27, holds that the purchaser of an annuity contract, by means of which the purchaser selected and controlled specified certificates of deposit issued by a savings and loan association, is considered the owner of the certificates for federal income tax purposes. Under the facts of both rulings, the purchasers possessed sufficient incidents of ownership with respect to the underlying investments or certificates so that the interest, dividends, or other income therefrom was held to be includible in gross income of the purchasers under section 61(a) of the Code.

In Rev. Rul. 81-225, 1981-2 C.B. 12, the Service described four situations in which investments in mutual funds, pursuant to annuity contracts, are considered owned by the policyholder (and not the insurance company) and one situation in which the insurance company is considered the owner of the investments. In the four situations in which the policyholders are considered the owners of the investment securities, the policyholders had investment control over the mutual fund shares and possessed sufficient other incidents of ownership to be considered the owners of the shares for federal income tax purposes. In each of the four situations the mutual fund shares were available for purchase not only by the prospective purchasers of the annuity contracts, but also by other members of the general public. The policyholders' position in each situation was substantially identical to what it would have been had the mutual fund shares been purchased directly by the policyholders. Conversely, in the situation in which the mutual fund shares were not available to the public and investment discretion did not rest with policyholders, the insurance company was considered to be the owner for federal income tax purposes.

Under Rev. Rul. 81-225, in order for the insurance company to be considered the owner of the mutual fund shares, control over individual investment decisions must not be in the hands of the policyholders. However, the ability to choose among broad, general investment strategies such as stocks, bonds or money market instruments, either at the time of the initial purchase or subsequent thereto, does not constitute sufficient control over individual investment decisions so as to cause ownership of the private mutual fund shares to be attributable to the policyholders.

HOLDING

IC, and not the policyholder, is the owner of the investment company shares for federal income tax purposes.

---

26 CFR 1.61-1: Gross income.
(Also Sections 72, 403, 408, 801; 1.72-1, 1.403(a)-1, 1.403(b)-1, 1.408-3, 1.801-8.)

Gross income; earnings; wraparound annuity contracts. Certain provisions of Rev. Rul. 81-225, relating to the circumstances in which the policyholders of certain annuity contracts ("wraparound annuities") will be treated for federal income tax purposes as the owners of the mutual fund shares held by the insurance company in connection with those annuities, are clarified.

Rev. Rul. 82-55 [1]

The Internal Revenue Service has been asked to clarify certain provisions of Rev. Rul. 81-225, 1981-2 C.B. 12, relating to the circumstances in which the policyholders of certain annuity contracts (commonly known as "wraparound annuities") will be treated for federal income tax purposes as the owners of the mutual fund shares held by the insurance company in connection with those annuities.

The following questions and answers will serve to clarify various aspects of Rev. Rul. 81-225.

---

[1] Also released as News Release IR-82-38, dated March 18, 1982. However, a typographical error in the last line of the answer to Question 2 has been corrected.

Question 1. May a mutual fund which is currently available to annuity purchasers and to the public be closed to further purchase by the public and thus be treated under Rev. Rul. 81-225 as owned by the insurance company?

Answer. When a mutual fund is "closed" so that its shares are no longer available for purchase by the public, it is no longer possible for a prospective purchaser to place himself in essentially the same position through purchase of an annuity as that in which he would have been had he purchased the mutual fund shares directly. Therefore, purchasers of annuity contracts whose funds are invested in mutual funds which were closed to the public prior to the purchase will not be treated as the owners of those mutual fund shares.

Holders of annuity contracts whose funds were invested in a publicly available mutual fund prior to its being closed, and subsequent to December 31, 1980, will be considered the owners of the mutual fund shares.

A mutual fund will not be considered as having been "closed" if existing public shareholders can continue to invest in that fund in any way other than through dividend reinvestment or through the purchase of an annuity contract.

Question 2. For contracts described in Situations 1 through 4 of Rev. Rul. 81-225, what will be the effect of post-1980 withdrawals and dividend reinvestment?

Answer. Under Rev. Rul. 81-225, amounts paid into annuity contracts and invested in mutual fund shares on or before December 31, 1980 will continue to be treated as having been paid into a segregated asset account and thus the insurance company and not the policyholders will be treated as the owner of the mutual fund shares.

Where the insurance company is treated as the owner of the mutual fund shares, dividends paid with respect to those shares will be taxable under section 801(g) of the Internal Revenue Code and the reinvestment of those dividends will be treated as amounts paid into the contract on or before December 31, 1980.

Conversely, where the policyholder is treated as the owner of the mutual fund shares (shares attributable to post-1980 payments), dividends paid with respect to those shares must be included in the policyholder's gross income, and reinvestment of these dividends will be treated as amounts paid into the contract *after* December 31, 1980.

A policyholder may, depending on the terms of his contract, withdraw amounts previously paid into the contract, and such withdrawals will be treated as first reducing any post-1980 payments he has made. However, any dividends which are attributable to post-1980 payments are nonetheless dividends paid with respect to shares owned by the policyholder, notwithstanding the subsequent withdrawal of the post-1980 payments.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 81-225 is clarified.

---

26 CFR 1.61-1: Gross income.
(Also Section 761; 1.761-2.)

Leveraged leases; electric generating facility coowner. The income tax consequences are set forth resulting from the operation of an electric generating facility by two utility corporations, when one of the utilities holds its interest in the facility under a lease that was part of a sale and leaseback transaction between the utility and a subsidiary of a financial institution.

Rev. Rul. 82-61

ISSUES

(1) Under the circumstances described below, is an undivided interest in an electric generating facility a property interest that can be separately leased in a leveraged lease transaction that otherwise qualifies under Rev. Proc. 75-21, 1975-1 C.B. 715?

(2) Does an undivided interest in an electric generating facility constitute "limited use property" as that term is defined in Rev. Proc. 76-30, 1976-2 C.B. 647?

(3) May the participants in a venture formed for the purpose of operating an electric generating facility, in which each participant has the right to and takes its share of the power generated, elect under section 761(a) of the Internal Revenue Code to have the venture excluded from the application of subchapter K, chapter 1 of the Code?

(4) Under the circumstances described below, is the relationship between *X* and *Y* that of partners in a partnership or merely that of coowners of an electric generating facility?

FACTS

X and *Z*, domestic utility corporations, contracted for the construction of a coal-fired electric generating facility on land owned by *X* and *Z* as tenants in common. The facility is located adjacent to a coal source sufficient to supply the facility with coal for its full estimated useful life. *X* and *Z* hold the right to mine the coal under a lease for a term equal to the estimated useful life of the facility. When the facility was completed, it was synchronized into a power grid that made commercially feasible the distribution and sale of electric power produced at the facility to a number of different electric utilities.

Before the facility was placed in service, *Z* sold its 50 percent undivided interest in the facility to *Y*, a leasing subsidiary of a domestic financial institution. *Y* financed 75 percent of the acquisition cost of the facility by executing a note to a third party lender. The note was a non-recourse note and was secured only by the facility and the rents to be paid for the use of the facility by *Z*. At the same time the transfer of the undivided interest in the facility took place, *Z* transferred to *Y*, for a term equal to the full estimated useful life of the facility, its interest in: (1) the land on which the facility is located; (2) the lease to mine the adjacent coal; and (3) the transmission facilities to the power grid.

Y then leased the 50 percent undivided interest in the facility back to *Z* for a period substantially less than its estimated useful life. Under the terms of the lease, *Y* is to receive 100*x* dollars each year of the lease term as rent on the facility. The 100*x* dollars represents the fair market rental value of the facility. *Y* is to receive this amount regardless of the profits or losses from the facility. In connection with this lease, *Z* acquired from *Y* the right to mine the coal under the lease on land adjacent to the facility and to use the transmission facilities to the power grid for a term equal to the lease term of the facility. *Y* and *Z* did not elect to treat the lease transaction under the provisions of section 168(f)(8) of the Code, which was added by section 201(a) of the Economic Recovery Tax Act of 1981, Pub. L. 97-34, 1981-2 C.B. 256, 275.

Y retained the right to lease or sell its undivided interest in the facility to any party at the expiration of the lease term. Because of its rights to the coal and transmission facilities to the power grid for a term equal to the full useful life of the facility, *Y*, at the end of the lease term, may take and dispose of its share of the power generated by the facility or lease or sell its undivided interest in the facility to electric utilities in addition to *Z* on a commercially feasible basis.

Operation of the facility is governed by an operating agreement between *X* and *Z*. The operating agreement sets forth how the facility is operated, how the costs of production are allocated, and how the electric power produced is distributed. Under the operating agreement, *X* and *Z* will take the electric power generated from their interest in the facility (*X*'s right arising from its ownership of a 50 percent undivided interest and *Z*'s right arising from its lease of *Y*'s 50 percent undivided interest) for their own use or for disposition. *X* and *Z* are obligated under the operating agreement to pay their proportionate shares of all operating and maintenance costs and to pay the actual cost of the fuel consumed to generate the power actually scheduled and produced for each of them. The term of the operating agreement is the same as the term of the lease between *Y* and *Z*.

The operating agreement also provides that *Y* has only the rights of a lessor and, otherwise, has no control over the operation of the facility, or over the production and distribution of power. *Y* has no right to share in any of the power generated by the facility. No costs of productions are allocated to *Y*, and *Y* is not obligated to pay any share of the operating or maintenance costs or the cost of the fuel consumed to generate the power actually scheduled or produced. *Y* was not held out as a participant in the operation of the facility.

LAW AND ANALYSIS

Rev. Proc. 75-21 sets forth guidelines that the Internal Revenue Service will use for advance ruling purposes in determining whether certain transactions purporting to be leases of property are, in fact, leases for federal income tax purposes. Rev. Proc. 75-21 covers the type of transaction commonly called a "leveraged lease," which involves three parties: a lessor, a lessee, and a lender to the lessor.

Rev. Proc. 76-30 provides that the Service will not issue advance rulings on leveraged lease transactions, as described in Rev. Proc. 75-21, when the transaction involves property that is considered "limited use property." Limited use property is generally defined in Rev. Proc. 76-30 as property not expected to be useful to or useable by the lessor at the end of the lease term, except for purposes of continued leasing or transfer to the lessee. Examples (5) and (6) of section 5 of Rev. Proc. 76-30, are specific examples of when an electric generating facility will be considered limited use property.

Section 761(a) of the Code provides that a partnership includes a syndicate, group, pool, joint venture or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on, and which is not a corporation, a trust, or an estate. Under the regulations, a qualifying partnership may elect to be excluded from the provisions of subchapter K, chapter 1 of the Code.

Section 1.761-1(a) of the Income Tax Regulations provides that the term "partnership" is broader in scope than the common law meaning of partnership and may include groups not commonly called partnerships. Mere coownership of property that is maintained, kept in repair, and rented or leased is not a partnership.

Section 1.761-2(a) of the regulations sets forth the conditions under which an unincorporated organization may elect to be excluded from all or part of the provisions of subchapter K, chapter 1 of the Code. Generally, to elect to be excluded under section 761(a) of the Code, the organization must be availed of for the joint production, extraction, or use of property but not for the purpose of selling services or property produced or extracted.

In addition, the participants in the organization must own the property as coowners, either in fee or under lease or other form of contract granting exclusive operating rights, and the participants must reserve the right separately to take the property produced in kind or dispose of their shares but may not jointly sell the property produced. The participants in the organization must also be able to compute their own income without having to compute partnership taxable income.

In Rev. Rul. 68-344, 1968-1 C.B. 569, the Service set forth a situation similar to the one outlined above. It concluded that the venture should be classified as a partnership for federal income tax purposes, and the participants in the venture could elect under section 761(a) and related regulations thereunder to be excluded from the provisions of subchapter K. *See also Madison Gas and Electric Co. v. Commissioner*, 633 F.2d 512 (7th Cir. 1980), *aff'g* 72 T.C. 521 (1979).

With respect to whether an undivided interest held by a tenant in common in an electric generating facility is the type of interest that can be separately leased for federal income tax purposes, the Service has recognized that an undivided interest represents a separate property interest for federal income tax purposes. In Rev. Rul. 78-268, 1978-2 C.B. 10, the Service held that because the investment tax credit is not allowable to certain cotenants does not preclude the other cotenants from claiming the credit on their undivided interests in the electric generating facility. Further, Rev. Rul. 70-607, 1970-2 C.B. 9, holds that the owner of land can lease an undivided interest in the land to purchasers of condominium units located on the land. See also Rev. Rul. 73-476, 1973-2 C.B. 300, which provides that taxpayers can each exchange an undivided interest owned as a tenant in common in separate parcels of real estate for a 100 percent ownership in one of the parcels.

Although these revenue rulings do not involve the leasing of undivided interests in a leveraged lease transaction, they indicate that an undivided interest in real property is an interest that can be leased separately from other undivided interests in the property. However, this does not mean that a transaction involving an undivided interest in property that is cast in the form of a lease will in all situations be classified as a lease for federal income tax purposes. It still must be demonstrated by the tenant in common that the lease of its undivided interest satisfies the requirements of Rev. Proc. 75-21 and Rev. Proc. 75-28, 1975-1 C.B. 752.

As to whether an undivided interest in an electric generating facility constitutes "limited use property" as defined in Rev. Proc. 76-30, this depends on whether the undivided interest in the facility can be disposed of or used by a party other than the lessee or whether the use of the facility is limited to the lessee. Thus, a determination must be made whether a party other than the lessee can operate the facility and, further, whether the other party can dispose of the electricity produced by the facility on a commercially feasible basis.

The facts in this revenue ruling are analogous to those in Example (6) of section 5 of Rev. Proc. 76-30, in which the Service indicated that an electric generating facility, under the circumstances described in the example, did not constitute "limited use property." The only significant difference is that instead of the entire facility being leased, as in Example (6) of Rev. Proc. 76-30, the lease in this revenue ruling involves an undivided interest in the facility. This difference does not, under the circumstances of this revenue ruling, cause the undivided interest in the facility under lease to become "limited use property" because: (1) at the end of the lease between *Y* and *Z*, *Y* will continue to hold an undivided interest in the facility with a substantial remaining useful life that will entitle it to a ratable share of the electrical capacity of the facility; (2) *Y* will hold an undivided interest in the coal lease capable of supplying the facility with coal for the remaining useful life of the facility; and (3) *Y* can dispose of the electricity produced by the facility on a commercially feasible basis because of the transmission system to the power grid. These factors insure that *Y* can dispose of or lease its undivided interest in the facility to utilities other than *Z*, and that these other utilities can operate and dispose of the electricity produced on a commercially feasible basis.

Whether *X* and *Z* can elect under section 761(a) of the Code to be excluded from the provisions of subchapter K, chapter 1, of the Code depends on whether the conditions set forth in section 1.761-2 of the regulations have been satisfied. In Rev. Rul. 68-344 the Service concluded that the participants in a venture similar to that described above could make the election under section 761(a) because the participants could determine their income from the venture without computing partnership taxable income, the participants actually took the electric power produced and disposed of it to their own customers, and the electric power produced was not sold jointly by the participants in the venture. Each of these requirements is also satisfied under the facts of this revenue ruling. However, unlike the venturers in Rev. Rul. 68-344, *Z* will not own an undivided interest in the facility but rather will hold a leasehold interest in the facility.

Section 1.761-2(a) of the regulations provides that for the participants to elect under section 761(a) of the Code to be excluded from the provisions of subchapter K, they must own the property "as coowners either in fee or under lease or other form of contract granting exclusive operating rights." The regulation does not require that the participants own any specific or equal ownership interest in the venture's property. Rather, the regulation only requires that the coowners have joint possession of the exclusive operating rights in the facility. Thus, irrespective of the legal characterization of the participants' interests, the interests will qualify under section 1.761-2(a) so long as the participants have exclusive operating rights to the property.

Under the facts presented, *X* and *Z* satisfy the coownership requirement because the term of the partnership is for the duration of the lease between *Y* and *Z*. Thus, for the duration of the partnership the rights possessed by *X* and *Z* with respect to the facility are not materially different. Each has the same operating rights in the facility during the lease term, which is also the term of the partnership, and these operating rights represent the exclusive operating rights to the property.

Whether *X* and *Y* are partners in a partnership or are mere coowners of a generating facility depends on whether *X* and *Y* intended to join together in order to carry on a business for joint profit or loss. The following factors, no one of which is conclusive, are evidence of this intent: (1) the agreement of the parties and their conduct in executing its terms; (2) the contributions, if any, that each party makes to the venture; (3) control over the income and capital of the venture and the right to make withdrawals; (4) whether the parties are coproprietors who share in net profits and who have an obligation to share losses; and (5) whether the business was conducted in the joint names of the parties and was represented to be a partnership. *See Commissioner v. Tower*, 327 U.S. 280 (1946), Ct.D. 1670, 1946-1 C.B. 11, *Commissioner v. Culbertson*, 337 U.S. 733 (1949), Ct.D. 1723, 1949-2 C.B. 5, and *Luna v. Commissioner*, 42 T.C. 1067 (1964).

Although both *X* and *Y* are owners of the generating facility, *Y* is entitled to a fixed dollar amount each year under the lease. Under the operating agreement, *Y* has no control over the operation of the generating facility and has no right to share in any power generated by the facility during the term of the lease and operating agreement. *Y* has no obligation to pay the costs of operation or maintenance of the generating facility. *Y* was not held out to be a participant in the operation of the facility.

HOLDINGS

(1) Under the circumstances described above, an undivided interest in an electric generating facility is a property interest that can be separately leased in a leveraged lease transaction that otherwise qualifies under Rev. Proc. 75-21.

(2) An undivided interest in an electric generating facility does not constitute "limited use property" as that term is defined in Rev. Proc. 76-30.

(3) The venture formed by *X* and *Z* may elect under section 761(a) of the Code to have the venture excluded from the application of subchapter K, chapter 1 of the Code.

(4) Under the circumstances described above, *X* and *Y* are not partners in a partnership; instead they are mere coowners of an electric generating facility.

---

26 CFR 1.61-1: Gross income.

Relocation assistance benefits. Relocation assistance benefits required to be paid to tenants by landlords under a municipal ordinance are includible in the gross incomes of the tenants.

Rev. Rul. 82-106

ISSUE

Are relocation assistance benefits paid by landlords to tenants under a municipal ordinance includible in gross income?

FACTS

Because of a critical shortage of rental housing in city *CI*, the governing board of *CI* enacted an ordinance that requires landlords to provide relocation assistance benefits to tenants who are to be evicted from their units because of the conversion of their buildings into condominiums or cooperatives.

The ordinance requires that if a landlord does not elect to provide a tenant with a suitable replacement unit, the landlord must pay the tenant a relocation fee. Certain "qualified tenants", defined as those who are over age 62, or who qualify as being handicapped or disabled, or who reside with one or more minor children must be paid 250*x* dollars. For all other tenants a landlord must pay a relocation fee of 100*x* dollars. The relocation fees are designed to assist all tenants in meeting the costs of relocation, higher rents for replacement units, and related expenses.

LAW AND ANALYSIS

Section 61(a) of the Internal Revenue Code provides that except as otherwise provided by law, gross income means all income from whatever source derived.

The Internal Revenue Service has consistently held that disbursements from a general welfare fund made under a legislatively provided social benefit program for the promotion of general welfare are not includible in a recipient's gross income. See, for example, Rev. Rul. 74-205, 1974-1 C.B. 20, concerning replacement housing payments received under the Housing and Urban Development Act of 1968, 1968-2 C.B. 734, and Rev. Rul. 76-373, 1976-2 C.B. 16, concerning relocation payments received under section 105(a)(11) of the Housing and Community Development Act of 1974.

However, the payments in this case are distinguishable from the replacement housing and relocation payments in Rev. Rul. 74-205 and Rev. Rul. 76-373. In those revenue rulings an agency of the federal government makes the payments to qualified recipients. Here, the landlords make the payments to tenants who are to be evicted. Payments made by individuals or other non-governmental entities are not considered payments for the general welfare. Moreover, the payments here in question are not based on need and are not a substitute for payments traditionally made by a governmental entity. Therefore, they do not come within the exemption from taxation for legislatively provided social benefit programs.

HOLDING

The relocation assistance benefits paid in this case by landlords to tenants under a municipal ordinance are includible in the gross income of the tenants under section 61 of the Code.

---

26 CFR 1.61-2: Compensation for services, including fees, commissions, and similar items.

Whether the surrender of a related option upon the exercise of a stock appreciation right (SAR), where the amount receivable upon the exercise of the SAR is limited to the price per share at which the related option could have been exercised on the exercise date, is the loss of a valuable right and, therefore, is a substantial limitation precluding constructive receipt of income by virtue of the appreciation of the employer's stock. See Rev. Rul. 82-121, page 79.

---

26 CFR 1.61-7: Interest.

Whether interest on obligations of a political subdivision of a state will be exempt from tax. See Rev. Rul. 82-21, page 17.

---

26 CFR 1.61-7: Interest.

Whether interest on obligations of a political subdivision of a state will be exempt from tax. See Rev. Rul. 82-44, page 18.

---

26 CFR 1.61-7: Interest.

Whether interest to be paid on bonds issued by a municipal housing authority will be exempt from tax. See Rev. Rul. 82-56, page 17.

---

26 CFR 1.61-7: Interest.

Whether an issue of general obligation bonds issued by a state are arbitrage bonds. See Rev. Rul. 82-101, page 21.

---

26 CFR 1.61-7: Interest.

Whether interest on obligations of a political subdivision of a state will be exempt from tax. See Rev. Rul. 82-117, page 19.

---

25 CFR 1.61-9: Dividends.

Whether a corporation that received dividends on stock of a domestic corporation purchase after the record date for the dividend payment has income. See Rev. Rul. 82-11, page 51.

26 CFR 1.61-14: Miscellaneous items of gross income.

Whether insurance proceeds received by the taxpayer as a result of the taxpayer's arson are includible in gross income. See Rev. Rul. 82-74, page 110.

Section 62.—Adjusted Gross Income Defined

26 CFR 1.62-1: Adjusted gross income.

Whether penalties for premature withdrawal of funds from a time savings account are deductible in arriving at adjusted gross income. See Rev. Rul. 82-27, page 32.

Part II.—Items Specifically Included in Gross Income

Section 72.—Annuities; Certain Proceeds of Endowment and Life Insurance Contracts

26 CFR 1.72-1: Introduction.

Whether the life insurance company or the policyholder is the owner for federal income tax purposes of the mutual fund shares under the circumstances described in the revenue ruling. See Rev. Rul. 82-54, page 11.

26 CFR 1.72-1: Introduction.

Clarification of certain provisions of Rev. Rul. 81-225, relating to the circumstances in which the policyholders of certain annuity contracts ("wraparound annuities") would be treated for federal income tax purposes as the owners of the mutual fund shares held by the insurance company in connection with those annuities. See Rev. Rul. 82-55, page 12.

Part III.—Items Specifically Excluded From Gross Income

Section 103.—Interest On Certain Governmental Obligations

26 CFR 1.103-1: Interest upon obligations of a state, territory, etc.
(Also Section 61; 1.61-7.)

Interest on bonds issued under the Housing Act of 1937. Interest on bonds that are exempt from federal income tax under the United States Housing Act of 1937, 42 U.S.C. section 1437i(b), is excludable from the gross income of the bondholders without regard to the provisions of section 103 of the Code. Rev. Rul. 60-248 modified.

Rev. Rul. 82-56

FACTS

A municipal public housing authority was created under state statute for the purpose of providing low-income housing projects. The authority is a "public housing agency" within the meaning of the United States Housing Act of 1937, section 3(6), 42 U.S.C. section 1437a(6) (1976). The authority proposes to issue bonds to finance the construction of a low-income housing project approved by the Department of Housing and Urban Development under 42 U.S.C. section 1437f and applicable regulations. The bonds will be used in connection with a low-income housing project described in 42 U.S.C. section 1437i(a) and will comply with all requirements set forth in 24 C.F.R. Part 811 (1981). The principal of and interest on the bonds will be payable only from lease revenues to be received from the tenants of the housing project and from annual contributions to be received from the United States Department of Housing and Urban Development.

Section 1437i(b) of the title 42 U.S.C. provides, in general, that obligations, including interest thereon, issued by public housing agencies in connection with low-income housing projects shall be exempt from federal taxation.

HOLDING

Interest paid on the bonds issued by the municipal public housing authority that are exempt from federal income taxation under 42 U.S.C. section 1437i(b) is excludable from the gross income of the bondholders without regard to the provisions of section 103 of the Internal Revenue Code. See *also* Rev. Rul. 76-202, 1976-1 C.B. 26, Rev. Rul. 71-402, 1971-2 C.B. 91, and Rev. Rul. 70-219, 1970-1 C.B. 23, which hold that interest paid on bonds that are tax-exempt under certain other provisions of law are excludable from the gross income of the bondholders without regard to the provisions of section 103.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 60-248, 1960-2 C.B. 35, holds that the interest on bonds issued by the New York State Housing Authority to finance construction of low-rent housing is exempt under section 103 of the Code. Although not stated in Rev. Rul. 60-248, the Authority in that revenue ruling is a public housing agency within the meaning of 42 U.S.C. section 1437a(6). Therefore, Rev. Rul. 60-248 is modified to hold that interest paid on bonds issued by the Authority that are exempt from federal taxation under 42 U.S.C. section 1437i(b) is excludable from the gross income of the bondholders without regard to the provisions of section 103.

26 CFR 1.103-1: Interest upon obligations of a state, territory, etc.

Procedures for requesting a ruling that obligations issued by a corporation formed under the general nonprofit corporation law of a state are issued on behalf of a governmental unit under section 1.103-1(b) of the Income Tax Regulations. See Rev. Proc. 82-26, page 476.

26 CFR 1.103-7: Industrial development bonds.
(Also Section 61; 1.61-7.)

Industrial development bonds; trade or business test; interest excludable. Municipal bonds to be issued to finance the acquisition for city use of an office building currently leased to a nonexempt person will not satisfy the "trade or business test" described in section 1.103-7(b)(3) of the regulations even though the nonexempt person will continue to use the building for not more than 1 year after the city acquires title. The bonds will not be industrial development bonds within the meaning of section 103(b)(2) of the Code and the interest on the bonds will be excludable from gross income under section 103(a)(1).

Rev. Rul. 82-21

ISSUE

Will a proposed issue of municipal bonds satisfy the "trade or business test" described in section 103(b)(2)(A) of the Internal Revenue Code and section 1.103-7(b)(3) of the Income Tax Regulations, under the circumstances described below?

FACTS AND LAW

The governing body of city *CI* has determined that more office space is required for the city's use. *CI* has located a suitable, newly constructed office building within its boundaries. However, the building is currently leased to corporation *X*, which is not an exempt person within the meaning of section 103(b)(3) of the Code. The unexpired term of *X*'s 10-year lease is 6 years. *CI*, *X*, and the owner of the building have entered into an agreement under which *CI* will issue bonds and use the proceeds to purchase the building. The agreement also provides that *X* will receive a specified amount for the cancellation of the last 5 years of the remaining term of the lease. Because of the difficulty *X* will have in immediately relocating, the agreement provides that *X* may continue to lease and use the building for not more than 1 year after *CI* buys the property.

CI proposed to issue 30-year bonds in an amount equal to the purchase price of the office building. The security for the payment of principal of and interest on the bonds will be a pledge of the building and the full faith and credit of *CI*. Title to the property will be transferred to *CI* subject to the amended lease provisions. After *X* vacates the building, *CI* will use all of it for governmental purposes.

The bonds will not be "arbitrage bonds" within the meaning of section 103(c)(2) of the Code.

Section 103(b)(2)(A) of the Code and section 1.103-7(b)(3) of the regulations, which deal with the "trade or business test," one of the requirements necessary for an obligation to be classified as an industrial development bond, provide that the "trade or business test" relates to the use of the proceeds of a bond issue. The test is met if all or a major portion (more than 25 percent) of the proceeds of a bond issue is used in a trade or business carried on by a nonexempt person. For example, if all or a major portion of the proceeds of a bond issue will be used to acquire facilities that will be leased to private business users for use in their trades or businesses, the proceeds will be used in a trade or business carried on by nonexempt persons, and the bonds will therefore satisfy the "trade or business test."

HOLDING

The bonds to be issued by *CI* will not satisfy the "trade or business test" described in section 103(b)(2)(A) of the Code and section 1.103-7(b)(3) of the regulations because the continued use of the building by *X* for a temporary period of not more than 1 year will not be considered the use of a major portion of the bond proceeds in the trade or business of a nonexempt person. Because the bonds fail to satisfy the "trade or business test," they will not be "industrial development bonds" within the meaning of section 103(b)(2) and the interest on the bonds will be excludable from gross income under section 103(a)(1). This holding will apply only in situations where a pre-existing lease by a nonexempt person continues for a period of not more than 1 year following the purchase of the property by the political subdivision.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 77-352, 1977-2 C.B. 34, concludes, in part, that the use by nonexempt lessees of an office building owned by an exempt person will satisfy the trade or business test. The facts in Rev. Rul. 77-352 are distinguishable from those in this revenue ruling. In Rev. Rul. 77-352 the building will be bought by the exempt person for the purpose of leasing it to nonexempt persons on a continuing or long-term basis, while in this revenue ruling the city will buy the building for its own use but will continue to lease the property to the present lessee, a nonexempt person, for a temporary period of not more than 1 year.

---

26 CFR 1.103-7: Industrial development bonds.

Procedures for requesting a ruling that a facility is not used in the trade or business of a nonexempt person within the meaning of section 103(b)(2)(A) of the Code. See Rev. Proc. 82-14, page 459.

---

26 CFR 1.103-7: Industrial development bonds.

Procedures for requesting a ruling that a facility is not used in the trade or business of a nonexempt person within the meaning of section 103(b)(2)(A) of the Code. See Rev. Proc. 82-15, page 460.

---

26 CFR 1.103-10: Exemption for certain small issues of industrial development bonds.
(Also Section 61; 1.61-7.)

Industrial development bonds; exempt small issue; interest excludable. Substantially all of the proceeds of an exempt small issue of industrial development bonds to be issued by a city will be considered used for the acquisition of qualified property described in sections 103(b)(6)(A) and (D) of the Code if the proceeds are used to purchase out-of-state manufacturing facilities that will be immediately exchanged for like kind property located within the city. The interest on the bonds will be excludable from gross income under section 103(a)(1).

Rev. Rul. 82-44

ISSUE

Will substantially all of the proceeds of a city's proposed industrial development bonds be considered used to acquire qualified property for purposes of section 103(b)(6)(A) and (D) of the Internal Revenue Code, under the circumstances described below?

FACTS

X, an industrial corporation, wants to acquire and use manufacturing facilities, consisting of land and buildings, located in city *CI* of state *N* that are currently owned and used by corporation *Y*. *Y*'s facilities have a fair market value of $9,000,000. *Y* refuses to sell the facilities to *X* for cash. However, *Y* has agreed to exchange the facilities for "like kind" property in a transaction in which *Y* will qualify for nonrecognition of gain or loss under section 1031 of the Code. *X* has located a manufacturing facility in state *R*, owned by corporation *Z*, with a purchase price of $9,000,000 that *Y* will accept in exchange for its facilities. There is no "substantial connection" between *Z*'s facilities and *Y*'s facilities or between *Z*'s facilities and *CI*. *X* has not previously owned or operated facilities in *CI*.

CI proposes to issue $9,000,000 of industrial development bonds and to loan the bond proceeds to *X* to finance the acquisition of the manufacturing facilities from *Y*. Before the bonds are issued, *CI* will make an election to have the bonds treated as an exempt small issue of $10,000,000 or less under section 103(b)(6)(D) of the Code. The bonds will not be arbitrage bonds within the meaning of section 103(c)(2). Upon receiving the bond proceeds, *X* will purchase the manufacturing facility from *Z* and immediately exchange it for *Y*'s facilities.

LAW AND ANALYSIS

Section 103(a)(1) of the Code provides that interest on obligations of a political subdivision of a state is excludable from gross income. Section 103(b)(1) provides that, with certain exceptions, industrial development bonds will not be treated as obligations described in Section 103(a)(1). As one of these exceptions, sections 103(b)(6)(A) and (D) provide that an exempt small issue in an aggregate face amount of $10,000,000 or less will not be treated as an industrial development bond if substantially all (90 percent or more) of the bond proceeds are to be used for the acquisition of land or property of a character subject to the allowance for depreciation. For purposes of determining the aggregate face amount of a bond issue described in section 103(b)(6)(D), there must be taken into account the face amount of the bonds to be issued, the outstanding face amount of certain prior exempt small issues, and the aggregate amount of certain capital expenditures with respect to certain facilities.

Section 1.103-8(a)(4) of the Income Tax Regulations provides that the question whether substantially all of the proceeds of an issue of obligations are to be used to provide exempt facilities described in section 103(b)(4) of the Code is to be resolved by reference to the ultimate use of the proceeds. Similarly, the question of whether substantially all the proceeds of an issue of obligations are to be used to acquire qualified property described in section 103(b)(6) is to be resolved by the ultimate use of the proceeds.

Rev. Rul. 77-281, 1977-2 C.B. 31, holds that municipal bonds to be issued to finance railroad rolling stock will not qualify as an exempt small issue under sections 103(b)(6)(A) and (D) of the Code because the two preconditions to the availability of such section will not be satisfied. Those preconditions are: (1) the location of facilities to be financed with an exempt small issue must be established within an incorporated municipality or within a county, and (2) the facility financed by the bonds must be located within the boundaries of the issuer (or within the boundaries of the political subdivision in which the issuer is located). A facility will be regarded as being located within the boundaries of the issuer (or within the boundaries of the political subdivision in which the issuer is located) if it has a substantial connection within such boundaries.

X's proposed purchase of *Z*'s facilities with bond proceeds will not be the acquisition of qualified property for purposes of sections 103(b)(6)(A) and (D) of the Code because one of the preconditions to the availability of such section will not be satisfied. *Z*'s facilities are not located in *CI*, and there is no substantial connection between *Z*'s facilities and *CI*. See Rev. Rul. 77-281.

However, although the proceeds to *CI*'s bonds will be used to purchase *Z*'s facilities in state *R*, the immediate subsequent exchange will result in *X* acquiring *Y*'s facilities located in *CI*. Thus, the ultimate use of the bond proceeds will be to acquire qualified facilities located within the boundaries of the issuer of the bonds.

HOLDING

Substantially all of the proceeds of *CI*'s bonds will be considered used to acquire qualified property for purposes of section 103(b)(6)(A) and (D) of the Code, under the circumstances described above. Therefore, because the exception provisions for an exempt small issue will apply, the interest on the bonds will be excludable from gross income under section 103(a)(1).

---

26 CFR 1.103-10: Exemption for certain small issues of industrial development bonds.
(Also Section 61; 1.61-7.)

Industrial development bonds; exempt small issue; capital expenditure. A savings and loan association plans to construct and occupy an office building using funds deposited by customers, and a city proposes to issue an exempt small issue of industrial development bonds to provide long-term financing for the building when it is completed. The interest to be paid by the savings and loan association on customers' deposits will not be a capital expenditure within the meaning of section 103(b)(6)(D) of the Code, and the interest on the city's bonds will be excludable from gross income under section 103(a)(1).

Rev. Rul. 82-117

ISSUE

Will interest paid by a savings and loan association on savings deposits be a "capital expenditure" within the meaning of section 103(b)(6)(D) of the Internal Revenue Code and section 1.103-10(b)(2)(ii)(*e*) of the Income Tax Regulations, under the circumstances described below?

FACTS

X, a savings and loan association, plans to purchase land and construct a new headquarters building in city *CI* for an estimated total cost of $10,000,000. *X* will use funds deposited by customers to buy the land and construct the building and will not incur specific construction indebtedness before or during construction. However, during the construction period, *X* will pay or incur interest on the savings deposits held by it for its customers. *X* has requested *CI* to issue bonds when the building is completed to provide long-term financing.

Before *X* begins construction, the governing body of *CI* will adopt a resolution evidencing an intent to issue bonds and loan the proceeds to *X* in exchange for a mortgage on the property and a mortgage note. *CI* proposes to issue bonds in the face amount of $10,000,000. Before the issuance of the bonds, *CI* will make a proper election to treat the bonds as an exempt small issue of $10,000,000 or less under section 103(b)(6)(D) of the Code. There will be no prior exempt small issues attributable to *X* outstanding at the time the bonds will be issued. *CI* has not expended and will not expend any funds with respect to the land and building to be located in *CI* during the 3 years before the date of issue of the bonds. *X* has not paid or incurred and will not pay or incur any capital expenditures with respect to any other facility within *CI* of which *X* was or will be the principal user during the 3-year period before the issuance of the $10,000,000 obligation. The bonds will not be arbitrage bonds within the meaning of section 103(c)(2).

LAW AND ANALYSIS

Section 103(a)(1) of the Code provides that gross income does not include interest on the obligations of a state or its political subdivisions.

Section 103(b)(1) of the Code provides that, except as otherwise provided in section 103(b), any industrial development bonds will be treated as an obligation that is not described in section 103(a)(1).

Section 103(b)(6)(D) of the Code provides that, at the election of the issuer, section 103(b)(1) will not apply to any obligation issued as part of an issue if the aggregate face amount of the issue is $10,000,000 or less and if substantially all (90 percent or more) of the proceeds of the issue are to be used to acquire or construct land or property of a character subject to the allowance for depreciation. To determine the aggregate face amount of a bond issue, the face amount of the bonds to be issued, the outstanding face amount of certain prior exempt small issues, and the aggregate amount of capital expenditures for certain facilities must all be taken into account.

Section 1.103-10(b)(2)(ii) of the regulations provides that an expenditure is a section 103(c)(6)(D) (redesignated as section 103(b)(6)(D)) capital expenditure if each of the following conditions is met:

(a) The capital expenditure was financed other than out of the proceeds of issues taken into account.

(b) The capital expenditure was paid or incurred during the 6-year period that begins 3 years before the date of issuance of the issue and ends 3 years after that date.

(c) The principal user of the facility in connection with which the property resulting from the capital expenditure is used and the principal user of the facility financed by the proceeds of the issue in question is the same person or two or more related persons.

(d) Both facilities referred to in (c) were located in the same incorporated municipality or in the same county (outside the incorporated municipality in the county).

(e) The capital expenditure was properly chargeable to the capital account of any person or state or local governmental unit (whether or not the person is the principal user of the facility or a related person), determined for this purpose without regard to any rule of the Code that permits expenditures properly chargeable to capital account to be treated as current expenses. With respect to obligations issued on or after August 8, 1972, determinations under the preceding sentence shall be made by including any expenditure that may, under any rule or election under the Code, be treated as a capital expenditure (whether or not such expenditure is so treated).

Section 266 of the Code provides that no deduction will be allowed for amounts paid or accrued for such taxes and carrying charges as, under the regulations prescribed by the Secretary, are chargeable to capital account with respect to property, if the taxpayer elects, in accordance with such regulations, to treat such taxes or charges as so chargeable.

Section 1.266-1(b)(1)(ii) of the regulations provides that with respect to real property, whether improved or unimproved and whether productive or unproductive, a taxpayer may elect to treat as chargeable to a capital account interest on a loan (but not theoretical interest of a taxpayer using the taxpayer's own funds) paid or incurred for the development of the real property or for construction of an improvement or additional improvement to such real property up to the time development or construction work has been completed.

Rev. Proc. 70-20, 1970-2 C.B. 499, sets forth guidelines for the application of section 265(2) of the Code to banks holding tax-exempt state and local obligations. Section 265(2) provides that no deduction shall be allowed for interest on indebtedness incurred or continued to purchase or carry obligations the interest on which is wholly exempt from federal income tax. Section 3.09 of Rev. Proc. 70-20 concludes that section 265(2) should not be deemed applicable to interest paid or accrued by banks or indebtedness that they incur in the ordinary course of their day-to-day business unless there are circumstances demonstrating a direct connection between the borrowing and the tax-exempt investment.

In this case *X* will use only funds obtained from customer savings deposits received in the ordinary course of its business to purchase the land and construct the building. *X* will not incur any specific or identifiable indebtedness attributable to the land or building before or during the construction period. Section 1.103-10(b)(2)(ii)(*e*) of the regulations requires that any expenditure that a taxpayer may elect to charge to the capital account under section 266 of the Code must be treated as a capital expenditure for purposes of section 103(b)(6)(D). However, in order to qualify for the election to capitalize interest under the provisions of section 1.266-1(b)(1)(ii), such interest must be interest on a loan paid or incurred for the development of real property or for construction of improvements to such property. The amounts *X* receives from depositors cannot be construed as loans to which section 266 applies because such deposits are received in the normal course of *X*'s business as a financial institution. See section 3.09 of Rev. Proc. 70-20. Because there is no interest paid or incurred on a loan attributable to *X*'s purchase of the land and construction of the building, *X* will not pay or incur any interest that is eligible to be charged to the capital account under section 266. Therefore, *X* will not pay or incur any interest attributable to the purchase of the land and construction of the building that will qualify as a capital expenditure under section 103(b)(6)(D).

HOLDING

The interest to be paid or incurred by *X* on savings deposits used to fund construction of the building will not be a capital expenditure within the meaning of section 103(b)(6)(D) of the Code and section 1.103-10(b)(2)(ii)(*e*) of the regulations. Therefore, the aggregate face amount of the bonds to be issued by *CI* when construction is completed will not exceed the $10,000,000 exempt small issue limitation and the interest on the bonds will be excludable from gross income under section 103(a)(1).

---

26 CFR 1.103-13: Arbitrage bonds.
(Also Section 61; 1.61-7.)

Arbitrage bonds; creation of fund and issuance of general obligation bonds in related transaction. A state established a perpetual fund with the proceeds from the sale of state-owned properties and invested the fund in taxable obligations with a yield materially higher than the yield on general obligation bonds that the state issued shortly afterwards as part of a series of related transactions. The income earned on the fund is reasonably expected to pay the debt on the bonds. The bonds are arbitrage bonds under section 103(c)(2)(B) of the Code.

Rev. Rul. 82-101 [1]

ISSUE

Are $100 million of general obligation bonds issued by state *ST* arbitrage bonds under section 103(c)(2) of the Internal Revenue Code under the circumstances described below?

FACTS

In February 1982, *ST* issued $100 million of its general obligation bonds to finance various capital improvements. The bonds are secured by the full faith and credit of *ST*. *ST* expects to earn $12 million from the investment of the bond proceeds in materially higher yield obligations pending their use to make capital improvements. Payments of debt service (principal and interest) on the bonds will be paid from the operating account of *ST*.

In 1981, *ST* realized $90 million on the sale of certain lands that it owned. The sales proceeds were invested in securities with the then highest obtainable yield.

Later in 1981, various officials of *ST* recommended that a fund be created and that the proceeds from the sale of the lands be deposited in the fund and invested in long-term United States Treasury obligations. The state officials recommended that the fund be maintained in perpetuity. The state officials anticipated that the creation of the fund would enable *ST* to sell $100 million of general obligation bonds at the time the fund was created without requiring increases in the existing or future tax rates of *ST*.

Under the law of *ST*, the creation of the fund and the issuance of general obligation bonds must be approved by both the legislature and the voters of *ST*. Each house of the *ST* legislature approved the creation of the fund and the issuance of the $100 million of general obligation bonds on the same day. The voters of *ST*, in a single state-wide election, approved the creation of the fund and the issuance of the $100 million of general obligation bonds.

Under the law of *ST*, the corpus of the fund may never be invaded or made subject to any lien for any purpose. Income may be appropriated from the fund for any purpose of *ST* only upon affirmative act of the *ST* legislature. The initial corpus of the fund is $95 million.

The issuance of the $100 million of general obligation bonds increased *ST*'s total outstanding indebtedness from $200 million to $300 million and its total outstanding general obligation indebtedness from $25 million to $125 million. The average total outstanding general obligation debt of *ST* has been $25 million over the last 5 years.

The average annual surplus in *ST*'s operating account has been $3 million over the last five years. Average annual debt service on the $100 million of general obligation bonds is $13.5 million. In January 1982, the $95 million held in the fund was invested in materially higher yielding obligations that will produce income of $13.5 million annually.

Under the law of *ST*, the annual expenditures of *ST*, including payment of debt service on its general obligation bonds, may not exceed *ST*'s revenues. If revenues are insufficient to pay expenditures, then all expenditures of *ST* must be prorated except those for essential government services and debt service on outstanding bonds.

The general obligation bonds are not industrial development bonds under section 103(b)(2) of the Code.

LAW AND ANALYSIS

Under section 103(a) of the Code, gross income does not include interest on the obligations of a state or a political subdivision of a state.

Generally, under section 103(c)(1) of the Code, any arbitrage bond is treated as an obligation not described in section 103(a).

Section 103(c)(2) of the Code defines an "arbitrage bond" as any obligation that is issued as part of an issue all or a major portion of the proceeds of which are reasonably expected to be used directly or indirectly (A) to acquire securities or obligations that may be reasonably expected, at the time of issuance of the issue, to produce a yield over the term of the issue that is materially higher than the yield on obligations of the issue, or (B) to replace funds that were used directly or indirectly to acquire securities or obligations described in section 103(c)(2)(A).

---

[1] Also released as News Release IR-82-51, dated April 30, 1982.

Section 103(c)(2)(B) of the Code applies to an issue of obligations if the proceeds are used to replace funds invested in securities having a yield that is materially higher than the yield on the obligations.

Rev. Rul. 78-348, 1978-2 C.B. 95, discusses the application of the replacement theory of section 103(c)(2)(B) of the Code. The replacement theory is based on the principle that an issuer that borrows to invest in higher yielding securities and one that borrows against such securities already owned are in virtually the same position. The revenue ruling provides that a requisite nexus or sufficiently direct relationship must exist between the bonds and higher yielding securities to apply section 103(c)(2)(B).

Section 1.103-13(g) of the Income Tax Regulations, pertaining to sinking funds, is one expression of the replacement theory of section 103(c)(2)(B) of the Code. See Rev. Rul. 78-349, 1978-2 C.B. 96. Under section 1.103-13(g), amounts held in a fund to the extent that the issuer reasonably expects to use the fund to pay principal or interest on the issue are treated as proceeds of the issue. Under this regulation, the nexus required by section 103(c)(2)(B) exists because the securities held in the sinking fund are reasonably expected to be used to pay principal or interest on the bonds.

In addition, Rev. Rul. 78-348 states that the nexus required by section 103(c)(2)(B) of the Code also exists where higher yielding securities are pledged as collateral for the bonds. The revenue ruling further states that the pledge need not be cast in a particular form. However, there must be a reasonable assurance that the collateral will be available if needed to pay debt service.

In Rev. Rul. 80-13, 1980-1 C.B. 27, a newly-created state authority that had no revenues or assets proposed to sell $50 million in bonds to study whether a hydroelectric power plant should be built. Under the indenture the bond proceeds could be spent, in general, only to the extent that the state legislature appropriated amounts that would be deposited in an escrow fund that would be used to retire the bonds if there were a default or if it were concluded that the power plant should not be built. The revenue ruling states that the fact that the escrow fund would not be fully funded by legislative appropriation on the date the bonds were to be issued would not prevent the application of section 103(c)(2)(B) of the Code. Further, the revenue ruling states that the bondholders would be looking to the escrow fund and not to the state authority for payment of debt service on the bonds because the authority had no current revenues or assets. Thus, the revenue ruling concludes that the proposed bonds would replace the amounts held in the escrow fund.

In Situation 2 of Rev. Rul. 80-328, 1980-2 C.B. 53, a political subdivision of a state proposed the contemporaneous issuance of notes and bonds to finance multi-family housing projects. The note proceeds were to be used to finance construction. The bond proceeds would be invested and held as security for the bondholders until construction of the projects was completed. The bonds would be used to retire the notes only upon completion of the projects. If a project was not completed within 3 years of the date the notes were issued, a portion of the bond proceeds would be used to retire that portion of the bonds allocable to the unfinished project. Nevertheless, Rev. Rul. 80-328 concludes that the notes would replace the bonds from the date the notes were to be issued.

In this case, all of the facts and circumstances indicate that *ST* reasonably expects to pay the debt service on the $100 million of general obligation bonds from the income generated by the investment of the fund in materially higher yielding obligations. The facts demonstrate that the creation of the fund and the issuance of the $100 million of bonds resulted from closely-related legislative enactments. In addition, the size of the general obligation bond issue increased the total indebtedness of *ST* by 50 percent and the general obligation indebtedness of *ST* by 400 percent.

Moreover, the average annual debt service on the bonds will be more than four times the average annual surplus that *ST* has had in its operating account over the last 5 years. In addition, the fund holding the proceeds from the sale of certain of *ST*'s properties is expected to earn $13.5 million annually. This amount alone is sufficient to pay the debt service on the bonds. Compare Rev. Ruls. 80-251, 1980-2 C.B. 40, and 80-339, 1980-2 C.B. 42, concerning industrial development bonds under section 103(b)(2) of the Code, which state that an underlying arrangement causing the security interest test to be met will always be inferred if the payments to be made by industrial users and the debt service on the bonds are approximately equal in present value. Further, because the law of *ST* requires that *ST*'s expenditures, except those for debt service on its bonds and essential government services, be prorated if *ST*'s revenues are not sufficient to pay expected expenditures, the bondholders are reasonably assured that the income from the fund will be available, directly or indirectly, if needed, to pay debt service, even if *ST* encounters financial difficulties. See Rev. Rul. 78-348. That the operating account will receive income from the fund only upon future affirmative actions of the *ST* legislature does not prevent the application of section 103(c)(2)(B), because all of the facts and circumstances indicate that *ST* reasonably expects the income from the fund to be used as the primary source for payment of debt service on the bonds. Compare Rev. Rul. 80-13, in which bonds were considered to replace future appropriations of a state legislature.

Therefore, although the form of the transaction is that debt service on the $100 million of the general obligation bonds will be paid from the general revenues of *ST* deposited in *ST*'s operating account, the substance of the transaction is that debt service will be paid from the income generated by the fund, the corpus of which *ST* reasonably expects to invest in materially higher yielding obligations throughout the bond term. Consequently, the bondholders are reasonably assured that the corpus of the fund will produce income that will be available to pay debt service on *ST*'s bonds even if *ST* encounters financial difficulties. Thus, the effect of *ST*'s $100 million of general obligation bonds is to borrow against securities invested with the corpus of the fund at a materially higher yield. Therefore, all or a major portion of the proceeds of the bonds replaces the fund, which is invested in securities at materially higher yields.

Under section 1.103-13(j) of the regulations a governmental obligation will be considered an arbitrage bond if it is issued in connection with a transaction or a series of transactions that attempt to circumvent the provisions of section 103(c) of the Code and sections 1.103-13, -14, or -15 by (1) enabling the issuer to use the difference between tax-exempt and taxable interest rates to gain a material financial advantage, and (2) increasing the burden on the market for tax-exempt obligations.

Section 1.103-13(j) of the regulations further provides that examples of increased burdens on the market for tax-exempt obligations include selling obligations that would not otherwise be sold, selling more obligations than would otherwise be necessary, and issuing obligations sooner or allowing them to remain outstanding longer than would otherwise be necessary.

In this case all of the facts and circumstances indicate that a primary objective of *ST* in creating the fund is to pay debt service on the $100 million of general obligation bonds. That is, *ST*, in a series of transactions in which it invests the fund in materially higher yield obligations and shortly afterwards issues general obligation bonds, is using the difference between tax-exempt and taxable interest rates to gain a material financial advantage.

Further, the fact that *ST* expects to pay debt service on the bonds from the income earned by the fund demonstrates that *ST* would not have sold the entire $100 million of general obligation bonds or would not have sold the entire $100 million issue at one time if the income from the fund were not available. Thus, *ST* sold obligations that would not otherwise have been sold and issued them sooner than would otherwise have been necessary.

Therefore, *ST*'s bonds were issued in connection with a series of transactions described in section 1.103-13(j) of the regulations.

HOLDING

ST's $100 million of general obligation bonds are arbitrage bonds within the meaning of section 103(c)(2) of the Code. Therefore, interest on the $100 million of general obligation bonds is not excludable from the gross income of the bondholders under section 103.

---

26 CFR 5c.103-2: Leases and industrial development bonds.

The determination of whether an obligation constitutes an industrial development bond shall be made without regard to the characterization of the transaction as a lease under section 168(f)(8). See T.D. 7800, page 35.

Section 103A.—Mortgage Subsidy Bonds

26 CFR 6a.103A-2: Qualified mortgage bond.

T.D. 7817

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 6a—TEMPORARY REGULATIONS UNDER TITLE 11 OF THE OMNIBUS RECONCILIATION ACT OF 1980

Modification of regulations relating to mortgage subsidy bonds.

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary income tax regulations relating to the tax-exempt status of interest on mortgage subsidy bonds. These regulations affect all purchasers and governmental issuers of tax-exempt housing bonds. The changes made by these regulations are necessary to modify certain provisions contained in the present temporary regulations.

DATE: These temporary regulations are effective for governmental obligations issued after April 24, 1979.

FOR FURTHER INFORMATION CONTACT: Harold T. Flanagan of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3294).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains amendments to the temporary regulations relating to mortgage subsidy bonds under section 103A of the Internal Revenue Code of 1954. These amendments modify Treasury Decision 7780, published in the FEDERAL REGISTER for July 1, 1981 (46 FR 34311) [1981-2 C.B. 25], which provided regulations under section 103A of the Code. Section 103A was enacted by the Omnibus Reconciliation Act of 1980 (Pub. L. 96-499, 94 Stat. 2660 [1980-2 C.B. 509, 512]). The temporary regulations provided by this document will remain in effect until superseded by final regulations on this subject.

EXPLANATION OF PROVISIONS

Section 103A of the Internal Revenue Code of 1954 provides that a mortage subsidy bond shall be treated as an obligation not described in section 103(a)(1) or (2). As such, the interest on a mortgage subsidy bond is not excludable from gross income. However, under section 103A(b)(2) a qualified mortgage bond and a qualified veterans' mortgage bond shall not be treated as a mortgage subsidy bond, and the interest thereon is excludable from gross income.

Presently, §6a.103A-2(b)(5)(iii) provides that the population of all areas of chronic economic distress may not exceed 20 percent of the total State population. The amendment provided by this Treasury decision deletes this restriction.

The temporary regulations under §6a.103A-2(b)(5)(vi) are amended so as to clarify that, other than for purposes of determining the amount of proceeds which are required to be used for residences in areas of chronic economic distress or for purposes of the extended temporary period, an area of chronic economic distress which is approved within 3 months prior to the date of issue or after the date of issue may be taken into account for an obligation.

Evaluation of the effectiveness of these regulations will be based on comments received from offices within the Treasury and the Internal Revenue Service, other governmental agencies, and the public.

NON-APPLICATION OF EXECUTIVE ORDER 12291

The Treasury Department has determined that this temporary regulation is not subject to review under Executive Order 12291 or the Treasury and OMB implementation of the Order dated April 28, 1982.

DRAFTING INFORMATION

The principal author of these temporary regulations is Harold T. Flanagan of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, on matters of both substance and style.

* * * * *

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 6a is amended as follows:

Section 6a.103A-2 is amended by deleting the first sentence in the flush material under subdivision (D) of paragraph (b)(5)(iii) and by adding new provisions at the end of paragraph (b)(5)(vi). The added provisions read as follows:

§6a.103A-2 Qualified mortgage bond.

* * * * *

(b) *Definitions and special rules.* ***

(5) *Areas of chronic economic distress.* ***

(vi) *** Residences located in areas designated as areas of chronic economic distress approved in accordance with this subparagraph within such 3-month period or after the date of issue, however, may be treated as targeted area residences. However, for purposes of paragraph (h)(2), relating to the specified portion of proceeds to be placed in targeted areas, and paragraph (i)(3)(ii)(A), relating to the 1-½ year temporary period, only areas approved as areas of chronic economic distress in accordance with this subparagraph at the time of issue may be taken into consideration.

* * * * *

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue it with notice and public procedure under subsection (b) of section 553 of title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved May 14, 1982.

JOHN E. CHAPOTON,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on May 19, 1982, 4:53 p.m., and published in the issue of the Federal Register for May 24, 1982, 47 F.R. 22360)

---

26 CFR 6a.103A-2: Qualified mortgage bonds.

Procedures for requesting income tax returns or income tax return information to satisfy certain requirements under the Temporary Income Tax Regulations under section 103A of the Code. See Rev. Proc. 82-16, page 461.

Section 116.—Partial Exclusion of Dividends and Interest Received by Individuals

Whether interest earned on an All-Savers Certificate that is redeemed prior to maturity and after the holder is declared incompetent is excludable from gross income. See Rev. Rul. 82-58, page 27.

Section 117.—Scholarships and Fellowship Grants

26 CFR 1.117-4: Items not considered a scholarships or fellowship grants.
(Also Section 7805; 301.7805-1.)

Scholarships and fellowships; VA stipends. The Service will not follow the *Wells* and *Anderson* decisions and will litigate cases in which amounts have been received by graduate students from the Veterans' Administration under circumstances substantially similar to those in *Wells* and *Anderson*. Rev. Rul. 59-118 reinstated; Rev. Rul. 65-59 revoked.

Rev. Rul. 82-57

The Internal Revenue Service has reconsidered its decision, announced in Rev. Rul. 65-59, 1965-1 C.B. 67, to suspend Rev. Rul. 59-118, 1959-1 C.B. 41, and not to litigate cases in which amounts have been received under circumstances substantially identical to those in *Wells v. Commissioner*, 40 T.C. 40 (1963), and *Richard A. Anderson v. United States*, Civil No. 3-59-238 (D. Minn., Nov. 15, 1960).

FACTS

Rev. Rul. 59-118 holds that amounts paid by the Veterans Administration to graduate students while serving a training period at VA hospitals as staff assistants, as a condition to receiving a doctoral degree from a university, do not represent scholarships or fellowship grants excludable under section 117 of the Internal Revenue Code. Rather, these are compensation for services rendered and are includible in gross income under section 61.

Rev. Rul. 65-59 states that, pending amendment of the Income Tax Regulations under section 117 of the Code, the Service will not litigate cases in which amounts have been received under circumstances substantially identical to those in *Wells* and *Anderson*. Rev. Rul. 65-59 also states that Rev. Rul. 59-118 will not be applied in disposing of cases involving stipends paid by the VA to graduate students while serving a training period as staff assistants at VA hospitals.

LAW AND ANALYSIS

Under section 117(a) of the Code, gross income does not include any amount received as a scholarship at an educational organization or a fellowship grant.

Section 117(b) of the Code provides that, for a candidate for a degree at an educational organization described in section 170(b)(1)(A)(ii), section 117(a) will not apply to that portion of any amount received that represents payment for teaching, research, or other services in the nature of part-time employment required as a condition to receiving the scholarship or the fellowship grant. However, if teaching, research, or other services are required of all candidates (whether or not recipients of scholarships or fellowship grants) for a particular degree as a condition to receiving the degree, the teaching, research, or other services will not be regarded as part-time employment.

Section 1.117-4(c) of the regulations provides that any amount paid or allowed to, or on behalf of, an individual to pursue studies or research is not considered an amount received as a scholarship or fellowship grant if the studies or research are primarily for the benefit of the grantor.

In *Bingler v. Johnson*, 394 U.S. 741 (1969), Ct. D. 1926, 1969-2 C.B. 17, the Supreme Court of the United States held that the definitions in section 1.117-4(c) of the regulations are proper, because they comport with the ordinary understanding of "scholarships" and "fellowships" as relatively disinterested, "no-strings" educational grants with no requirement of any substantial *quid pro quo* from the recipients. The Court also stated that the thrust of the provision dealing with compensation is that bargained—for payments, given only in return for services rendered—whether past, present, or future—should not be excludable from income as "scholarship" funds.

In *Turem v. Commissioner*, 54 T.C. 1494, 1505 (1970), the court, in referring to *Bingler v. Johnson*, stated that the regulations are designed in part to distinguish relatively disinterested payments made primarily to further the recipient's education from payments made primarily to reward or induce the recipient's performance of services for the benefit of the grantor.

If payments are made to compensate recipients for participating in a course of training that prepares them to perform services in a program of the grantor, they are not the type of disinterested, "no strings" grants described in *Bingler v. Johnson* because they are made primarily for the benefit of the grantor. As a result, they are not excludable under section 117 of the Code. Rev. Rul. 68-312, 1968-1 C.B. 59. The express purpose of the payments in *Wells* was to furnish a continuing source of qualified staff psychologists for the VA hospitals and to provide needed services for which psychological technicians would otherwise have to be employed. These payments were, therefore, designed to compensate the recipients for participating in a course of training that prepared them to perform services in a program of the grantor. Consequently, despite the court's findings that the taxpayer did not perform substantial services and that the primary purpose of the payments was to aid in training the recipients, the payments in *Wells* were made primarily for the benefit of the grantor and, hence, are not excludable from gross income under section 117. The fact that the recipients were not legally bound to perform future services does not change this conclusion. *Ehrhart v. Commissioner*, 57 T.C. 872 (1972), *aff'd* 470 F.2d 940 (1st Cir. 1973). Also see, *Smith v. Commissioner*, 60 T.C. 279 (1973) and *Ide v. United States*, File CA 6452 (W.D. Mich., June 12, 1973).

In addition, although *Wells* holds that the VA payments in that case are excludable from gross income under section 117 of the Code, that case is not controlling in the situation described in Rev. Rul. 59-118. In *Wells*, the court found that the recipients of the payments did not perform substantial services, while the taxpayer in Rev. Rul. 59-118 was an essential part of the psychology services at the hospital. Accordingly, *Wells* and Rev. Rul. 59-118 are distinguishable on their facts.

The taxpayer in *Anderson* was a candidate for an advanced medical degree at a university and, as part of that program, was an assistant resident at a VA hospital. The jury in *Anderson* concluded that the services performed by the taxpayer were required of all candidates for the degree in question, and, therefore, the court held that payments received from the VA were excludable from gross income under section 117 of the Code.

However, the "all candidates" provision of section 117(b) of the Code is a factor only if it is first determined that the payments in question have the normal characteristics of a scholarship. If the payments do not have these characteristics (for example, if they are compensation for services), they cannot be excluded from gross income under section 117 even if the services in question are required for all degree candidates. *Brubakken v. Commissioner*, 67 T.C. 249, 254 (1976); Rev. Rul. 73-218, 1973-1 C.B. 53.

Therefore, the jury in *Anderson* should first have considered whether the payments in question had the normal characteristics of a scholarship and then considered the applicability of the "all candidates" exception of section 117(b)(1) only if it found that the payments had these characteristics.

HOLDING

The Service will not follow *Wells* and *Anderson* and will litigate cases in which amounts have been received under circumstances substantially similar to those in *Wells* and *Anderson*.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 59-118 is reinstated.
Rev. Rul. 65-59 is revoked.

PROSPECTIVE APPLICATION

Under the authority in section 7805(b) of the Code, the provisions of this revenue ruling will not be applied to amounts received prior to April 5, 1982, the date this revenue ruling is published in the Internal Revenue Bulletin.

Section 121—One-Time Exclusion of Gain From Sale of Principal Residence by Individual Who Has Attained Age 55

26 CFR 1.121-1: Gain from sale or exchange of residence of an individual who has attained age 55.
(Also Section 691; 1.691(a)-1.)

Sale of residence completed by executor; 55-year old taxpayer. The gain from the sale of a personal residence by the executor of an estate under an executory contract entered into prior to death by a 55-year old taxpayer qualifies for the exclusion under section 121 of the Code. Rev. Rul. 70-459 revoked.

Rev. Rul. 82-1

ISSUE

Is gain from the sale of a personal residence excludable from gross income pursuant to section 121 of the Internal Revenue Code under the circumstances described below?

FACTS

A taxpayer, who used the cash receipts and disbursements method of accounting, held title to a personal residence solely in the taxpayer's name. The taxpayer met all the age, use, and holding requirements of section 121 of the Code relating to the treatment of gain from sale or exchange of a principal residence by an individual who has attained age 55. The taxpayer had not previously made an election under section 121 with respect to any prior sale.

The taxpayer entered into a binding executory contract to sell the residence and accepted a down payment. The terms of the contract called for delivery of the deed and possession of the property upon receipt of the balance of the purchase price. After substantial fulfillment of the prerequisites to consummation of the sale and with only ministerial obligations remaining to be performed under the contract, but prior to closing the sale, the taxpayer died and the sale was completed when the executor of the taxpayer's estate received payment in full and delivered the deed.

LAW AND ANALYSIS

Section 121 of the Code provides that at the election of the taxpayer, gross income does not include gain, subject to certain limitations, from the sale or exchange of property if the taxpayer has attained the age of 55 before the date of such sale or exchange, and during the five-year period ending on the date of the sale or exchange, such property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating three years or more.

Section 691 of the Code provides that all items of income due a decedent, but which are not properly reportable in the decedent's final return, constitute income in respect of a decedent, and are included in the gross income of either the decedent's estate or of another recipient.

Section 691(a)(3) of the Code provides that the character of income in respect of a decedent is to be determined by reference to the character of such income in the decedent's hands had the decedent lived.

Section 1.691(a)-1(d) of the Income Tax Regulations provides that any item excluded from gross income under subtitle A of the Code is not income in respect of a decedent.

Section 1.691(a)-3(a) of the regulations provides that the right to receive any amount of income in respect of a decedent shall be treated in the hands of the estate as if it had been acquired in the transaction by which the decedent acquired such right, and shall be considered as having the same character it would have had if the decedent had lived and received such amount. The regulation further provides that the basis provisions of section 1014(a) of the Code do not apply to amounts of income in respect of a decedent received by estates or beneficiaries.

Section 6903 of the Code provides that a person acting for another in a fiduciary capacity shall assume the power, rights, duties and privileges of such other person.

A sale of real property takes place, for federal income tax purposes, at the time a deed passes or at the time possession and the burdens and benefits of ownership are transferred to the buyer. Rev. Rul. 69-93, 1969-1 C.B. 139.

In Rev. Rul. 78-32, 1978-1 C.B. 198, the decedent, prior to death, entered into a binding contract to sell real property and had substantially fulfilled the prerequisites to consummation of the sale. At the time of the decedent's death, the only remaining obligations to be performed were ministerial. Rev. Rul. 78-32 holds that the gain from the sale of this property that was completed by the decedent's executor is income in respect of a decedent under section 691(a) of the Code.

Consistent with the extension of rights and privileges accorded a fiduciary under section 6903, the executor may "stand in the shoes" of the decedent for purposes of making the election under section 121, with respect to the sale of the residence described herein. However, if the executor chooses not to make the election under section 121, or to the extent that the gain exceeds the amount excludable under section 121, the provisions of section 691(a), relating to income in respect of a decedent, will apply. Rev. Rul. 78-32.

HOLDING

The gain from the sale of the decedent's personal residence is excludable to the extent provided under section 121 of the Code if the election is made by the executor on the decedent's final Federal Income Tax Return (Form 1040). Any gain in excess of the amount excludable under section 121 will be income in respect of a decedent within the meaning of section 691(a). If the executor chooses not to make the section 121 election on the decedent's final return, the proceeds of sale of the residence are income in respect of a decedent within the meaning of section 691(a) and, because the basis provisions of section 1014 are made inapplicable by section 1014(c), the basis of the property in the hands of the estate will be determined by reference to the decedent's basis in the property immediately prior to the decedent's death.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 70-459, 1970-2, C.B. 22, which holds that an executor cannot elect the benefits of section 121 of the Code on the sale of a personal residence under similar circumstances to those described in this ruling, and that the basis of the residence in the hands of the executor is determined under section 1014(a), is revoked.

Section 128.—Interest On Certain Savings Certificates

26 CFR 5c.128-1: Exclusion of interest on certain savings certificates.
(Also Section 116)

All-Savers Certificate; holder declared incompetent; redemption prior to maturity. The interest earned on an All-Savers Certificate that is redeemed prior to maturity and after the holder is declared incompetent is includible in the holder's gross income in the year the certificate is redeemed.

Rev. Rul. 82-58

ISSUE

Is the interest earned on an All-Savers Certificate exempt from federal income tax under the circumstances described below?

FACTS

A, an individual taxpayer, purchased an All-Savers Certificate on October 1, 1981, with an annual investment yield of 12.61 percent. On December 15, 1981, *A* was declared to be incompetent by a court of competent jurisdiction. On December 16, 1981, *A*'s All-Savers Certificate was redeemed, and the principal and accrued interest were withdrawn. Under the current rules of depository institution regulatory agencies, the early withdrawal penalty does not apply when the owner of the time deposit has died or been declared incompetent.

LAW AND ANALYSIS

Section 128(a) of the Internal Revenue Code provides that gross income does not include any amount received by an individual during the taxable year as interest on a depository institution tax-exempt savings certificate.

Section 128(c)(1) of the Code provides in general that the term "depository institution tax-exempt savings certificate" means any certificate (1) that is issued by a qualified savings institution after September 30, 1981, and before January 1, 1983, (2) that has a maturity of one year, (3) that has an investment yield equal to 70 percent of the average investment yield for the most recent auction (before the week in which the certificate is issued) of United States Treasury bills with maturities of 52 weeks, and (4) that is made available in denominations of $500.

Section 128(e)(1) provides in general that if any portion of a depository institution tax-exempt savings certificate is redeemed before the date it matures (1) section 128(a) will not apply to any interest on such certificate for the taxable year of redemption and any subsequent taxable year, and (2) there will be included in gross income for the taxable year of redemption the amount of any interest on the certificate excluded under section 128(a) for any preceding taxable year.

Section 128(f)(2) of the Code and section 5c.128-1(e)(1) of the Temporary Income Tax Regulations (see example 4) provide that the rules set forth in section 128(e)(1) of the Code will not apply if the All-Savers Certificate is acquired by the certificate holder's estate upon the death of the certificate holder. However, if the estate subsequently redeems the All-Savers Certificate before maturity, the early withdrawal penalty provisions of section 128(e)(1) will apply.

Similarly, the early withdrawal penalty provisions of section 128(e)(1) of the Code will not be applicable if the holder of an All-Savers Certificate is declared legally incompetent. However, if the certificate is subsequently redeemed before maturity, the early withdrawal penalty provisions of section 128(e)(1) are applicable. Accordingly, the interest earned on the All-Savers Certificate in this case will be includible in the holder's gross income in the year the certificate is redeemed.

HOLDING

The interest earned on the All-Savers Certificate that is redeemed prior to maturity and after the holder is declared incompetent is includible in the holder's gross income in the year the certificate is redeemed. Further, this interest is not excludable from gross income under section 116 of the Code. See section 5c.128-1(f) of the temporary regulations.

---

26 CFR 5c.128-1: Exclusion of interest on certain savings certificates.

Whether the interest earned on a six-month money market certificate is includible in the recipient's gross income in the year it is "rolled over" into an All-Savers Certificate. See Rev. Rul. 82-42, page 77.

---

26 CFR 5c.128-1: Exclusion of interest on certain savings certificates.

When interest earned on an All-Savers Certificate is reportable by the taxpayer. See Rev. Rul. 82-113, page 78.

Part VI.—Itemized Deductions for Individuals and Corporations

---

Section 162.—Trade or Business Expenses

26 CFR 1.162-1: Business expenses.

Whether an individual taxpayer may deduct service fees charged by a bank against an interest-bearing checking account under section 212 of the Code. See Rev. Rul. 82-59, page 47.

---

26 CFR 1.162-2: Traveling expenses.
(Also Section 262; 1.262-1.)

"Home leave" expenses; foreign service member. A member of the United States foreign service may deduct substantiated "home leave" expenses as business traveling expenses under section 162(a)(2) of the Code. Rev. Rul. 68-513 revoked.

Rev. Rul. 82-2

ISSUE

May a member of the United States foreign service deduct substantiated "home leave" expenses as business traveling expenses under section

162(a)(2) of the Internal Revenue Code?

FACTS AND LAW

A, an individual, is a member of the United States foreign service stationed in country *FC*. On August 1, 1981, *A* returned to the United States for "home leave" as required by the Foreign Service Act of 1980, section 903, 22 U.S.C.A. section 4083 (1981 Supp.), and spent 4 weeks visiting various parts of the country. After completing the "home leave," *A* returned to *A*'s post of duty in *FC*.

Under section 903 of the Act, the successor of section 933(a) of the Foreign Service Act of 1946, members of the foreign service who are United States citizens are required to take a leave of absence from regular duties upon completion of 3 years of continuous service abroad. Leave may be taken in the United States, its territories and possessions, or the Commonwealth of Puerto Rico. The time of any work or duties required of a member while on mandatory leave is not counted as leave.

Rev. Rul. 68-513, 1968-2 C.B. 114, holds that amounts paid by a United States foreign service officer for travel, meals, and lodging while on "home leave" are nondeductible personal expenditures under section 262 of the Code rather than deductible business traveling expenses under section 162(a)(2).

In *Stratton v. Commissioner*, 448 F. 2d 1030 (9th Cir. 1971), *rev'g and rem'g* 52 T.C. 378 (1969), the court held that substantiated "home leave" expenses of a United States foreign service officer are deductible business traveling expenses under section 162(a)(2) of the Code. However, such expenses for the foreign service officer's family remain nondeductible personal, living, or family expenses under section 262.

HOLDING

The Service will follow the decision of the United States Court of Appeals for the Ninth Circuit in *Stratton* and the decisions in *Hitchcock v. Commissioner*, 578 F. 2d 972 (4th Cir. 1978), *Brewin v. Commissioner*, 639 F. 2d 805 (D.C. Cir. 1981), and *Teil v. Commissioner*, 639 F. 2d 805 (D.C. Cir. 1981), which are consistent with *Stratton*, as precedent in the disposition of similar cases involving sections 162 and 262 of the Code. Therefore, *A* may deduct under section 162(a)(2) of the Code the substantiated amounts paid for travel, meals, and lodging incurred by *A* while *A* was on "home leave."

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 68-513 is revoked.

---

26 CFR 1.162-2: Traveling expenses.

Travel expenses; state legislator; home in district. Deductible travel expenses are explained for a state legislator who elects under section 162(i) of the Code to have his or her place of residence within the represented legislative district considered his or her tax home. Rev. Rul. 79-16 superseded.

Rev. Rul. 82-33

ISSUE

What is the federal income tax treatment of a state legislator's travel expenses if the legislator has elected under section 162(i) of the Internal Revenue Code to have his or her place of residence within the legislative district that he or she represents considered as the tax home?

FACTS

B, a state legislator, has made an election under section 162(i) of the Code to have *B*'s place of residence in the district represented considered as *B*'s tax home. *B*'s residence is located more than 50 miles from the state capitol, where the legislative sessions are held. When the legislature is not in session, *B* incurs other travel expenses in the pursuit of *B*'s trade or business as a legislator for travel in the district *B* represents, in the state capitol, and in other cities. *B* does not receive a per diem allowance for attending legislative sessions.

LAW

Section 162(a) of the Code allows a taxpayer to deduct all the ordinary and necessary expenses paid or incurred during the tax year in carrying on any trade or business, including traveling expenses. Traveling expenses include amounts spent for meals and lodging (other than amounts that are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business.

The Economic Recovery Tax Act of 1981, section 127, 1981-2 C.B. 256, 274, added section 162(i), (originally enacted as section 162(h); subsequently redesignated by section 2146 of Pub. L. 97-35, 1981-2 C.B. 528, 530) relating to state legislators' travel expenses away from home, to the Code, effective for tax years beginning after December 31, 1975. Section 162(i) provides that, for purposes of section 162(a), if an individual who is a state legislator at any time during the tax year makes an election under section 162(i) for the tax year, the individual's place of residence within the legislative district that he or she represented will be considered his or her home. Section 162(i) further provides that the individual will be considered to have spent for living expenses (in connection with his or her trade or business as a legislator) an amount computed in the following way. The number of legislative days of the individual during the tax year is multiplied by the larger of (1) the amount generally allowable with respect to such days to employees of the state of which the individual is a legislator for per diem while away from home, but only up to 110 percent of the amount described in clause (2) below with respect to such days, or (2) the amount generally allowable with respect to such days to employees of the executive branch of the Federal Government for per diem while away from home, but still in the United States.

Section 162(i)(1)(C) of the Code states that the individual will be deemed to be away from home in pursuit of a trade or business on each legislative day.

Section 162(i)(2) of the Code defines the term "legislative day" as any day during the tax year that the legislature is in session (including any day in which the legislature is not in session for a period of 4 consecutive days or less), or any day the legislature is not in session but the physical presence of the individual is formally recorded at a meeting of a committee of the legislature.

Section 162(i)(4) of the Code provides that section 162(i) will not apply for tax years beginning after December 31, 1980, to any legislator whose place of residence within the legislative district he or she represents is 50 or fewer miles from the capitol building of the state.

HOLDINGS

1. Because *B* elected as the tax home *B*'s place of residence within the legislative district, it will be treated as *B*'s tax home for all legislative travel including travel between sessions.

2. The term "living expenses," as used in section 162(i) of the Code, refers to traveling expenses otherwise deductible under section 162(a), including expenses of meals and lodging, laundry expenses, and other expenses incidental to travel while away from home in pursuit of the individual's legislative trade or business. The term does not include travel fares, costs of telegrams or telephone calls, or local transportation expenses for business purposes.

3. "Legislative days" do not include the days of any recess period of more than 4 consecutive days. The 4-day limit is not extended by Saturdays, Sundays, or holidays.

4. The amount generally allowable to employees of the executive branch of the Federal Government for per diem while away from home but still in the United States, as referred to in section 162(i) of the Code, is the maximum amount allowable to employees of the executive branch of the Federal Government for per diem in the particular city in which the state capitol is located.

5. Any amount deductible by reason of section 162(i) of the Code is in addition to any other deduction allowed under section 162(a) of the Code for the other travel expenses incurred by *B* while away from home. This includes business expenses incurred when the state legislature is not in session or for travel fares, costs of telegrams or telephone calls, or local transportation expenses for business purposes.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 79-16, 1979-1 C.B. 91, relating to the tax treatment under section 604 of the Tax Reform Act of 1976, 1976-3 C.B. (Vol. 1) 1, 51, of travel expenses incurred by state legislators, is superseded for tax years beginning after December 31, 1975.

---

26 CFR 1.162-4: Repairs.

Whether the cost of replacing telephone wires with buried cable is to be currently expensed as a repair under section 162(a) of the Code or capitalized under section 263(a) and depreciated over its useful life under section 167(a). See Rev. Rul. 82-12, page 52.

---

26 CFR 1.162-10: Certain employee benefits.

Advance consent is granted to change the method of accounting from deducting fully-vested vacation pay in the tax year it is paid to deducting it in the tax year in which it accrues. See Rev. Proc. 82-32, page 486.

26 CFR 1.162-10: Certain employee benefits.

What are the tax consequences to a corporation that makes contributions to a trust formed to pay the corporation's obligations under the state workmen's compensation act. See Rev. Rul. 82-95, page 101.

---

26 CFR 1.162-15: Contributions, dues, etc. (Also Section 501; 1.501(c)(6)-1.)

Annual dues; membership in trade association; loan fund. A member of a trade association may deduct under section 162(a) of the Code the increased dues charged to all members of the association by the association when the increased charges are allocated to a special loan fund to be used for the benefit of the association's members.

Rev. Rul. 82-15

ISSUE

In the event that a trade association increases its dues to all members to cover the cost of establishing a strike loan fund, may the members of the trade association deduct under section 162(a) of the Internal Revenue Code increased charges they pay to the association as part of their annual dues if the additional charges are allocated to this special loan fund?

FACTS

Y, a domestic corporation, is a shareholder-member of *X* trade association, a member-owned organization that is exempt from tax under section 501(c)(6) of the Code. *X* was organized to represent its members in collective bargaining and related labor relations matters with a labor union. *X*'s by-laws provide that all members must pay dues promptly to remain in good standing. *Y* properly deducts the dues it pays to *X* under section 1.162-15(c) of the Income Tax Regulations.

X has established a loan fund to be used by any member who is experiencing a strike and needs a loan to continue in business and to continue to participate in collective bargaining with the labor union. All members of *X* are required to pay an increased dues charge to support the loan fund. There is no relationship, however, between eligibility for, or the size of, the loans and the dues payment uniformly required of members.

Amounts received as increased dues payments are earmarked for the loan fund, which is administered by a committee appointed by *X*'s board of directors. *X*'s loans are made only to its members during strikes, and then only under circumstances establishing that a member would not be able to continue in business and to bargain in good faith without a loan. Loan applications are evaluated by using criteria similar to those used by lending institutions. Default on repayment results in the initiation of collection procedues and suspension of the borrower's membership in *X*.

If the loan fund is terminated, any remaining amounts will be used to further *X*'s section 501(c)(6) purposes. Establishment of the loan fund does not affect *X*'s status under section 501(c)(6) of the Code.

LAW AND ANALYSIS

Section 162(a) of the Code allows a deduction for all the ordinary and necessary expenses paid or incurred during the tax year in carrying on any trade or business.

Section 1.162-15(c) of the regulations provides that dues and other payments to an organization, such as a labor union or a trade association, which otherwise meet the requirements of the regulations under section 162, are deductible in full.

In the present situation, *Y* is paying increased dues to *X* so that *X* may provide an additional service of common interest and benefit to its members. These additional payments by *Y* do not result in the acquisition by *Y* of any permanent interest in property. Rather, these payments entitle *Y* to the benefits of continued membership in *X*. As a result of the increased charges, these benefits now include use of the loan fund by *Y* if *Y* meets the requirements for obtaining a loan.

HOLDING

Each member of a trade association may deduct under section 162(a) of the Code as part of its annual dues the increased charges it pays to the association that are allocated to a special loan fund like the one described above.

---

26 CFR 1.162-18: Illegal bribes and kickbacks.

Whether a deduction under section 162 of the Code will be allowed to a taxpayer that pays a third party to burn down a building. See Rev. Rul. 82-74, page 110.

Section 163.—Interest

26 CFR 1.163-1: Interest deduction in general. (Also Section 263; 1.263(a)-1.)

Interest; installment sale of timber cutting rights. A timber company assigned its right to cut timber on U.S. Forest Service land to a promoter who sold the rights to a limited partnership. Under the terms of the installment contract the total "interest" and principal payments the partnership will pay the promoter equal the promoter's obligation to the timber company plus an override. The amounts designated as "interest" are part of the sales price.

Rev. Rul. 82-78

ISSUE

Under the circumstances described below, is a payment described as interest deductible as such under section 163 of the Internal Revenue Code?

FACTS

X, a timber company, successfully bid for a United States Forest Service contract right to cut timber on Forest Service land. *X* was required to make a deposit of $1x$ dollars, and the remaining amount, estimated at $22x$ dollars, is to become due and payable only as the timber is cut. If a greater or lesser volume of timber is harvested than was estimated by *X* and the Forest Service, the price is adjusted accordingly.

The contract with the Forest Service grants *X* the right to cut timber on the Forest Service land at any time within a 5-year period. The contract prohibits assignment without prior written Forest Service approval, and such approval would not relieve *X* of its responsibilities and liabilities under the contract. Title to the timber remains with the Forest Service until it is cut by *X*.

If *X* fails to cut the designated timber under the contract, the Forest Service may recover damages. However, the Forest Service bears the risk of loss of the timber by destruction or otherwise prior to its being cut by *X*.

Shortly after *X* secured its contract rights, *A*, a tax shelter promoter, took an assignment of the rights and obligations of *X* under the contract in return for $1x$ dollars. *A* then organized *LP*, a limited partnership, with *A* as the general partner. *A* purportedly sold the timber cutting rights that it had received from *X* to *LP* for installment payments totalling $16x$ dollars. In addition, *LP* agreed to pay *X* simple "interest" of approximately $8x$ dollars over the life of this sales contract. The installment obligation was secured only by the timber cutting rights transferred.

LP agreed to pay *A* $1x$ dollars in the first year of the contract, $2x$ dollars in year 2, $5x$ dollars in year 3, $1.5x$ dollars in year 4, and $6.5x$ dollars in year 5, plus "interest" yearly on the unpaid balance. The timing and amount of the payments were set to coincide with the proposed cutting schedule and, accordingly, with *X*'s payments to the Forest Service. Thus, the amount of the payment was adjustable, based on the amount of timber actually cut during the year. Furthermore, it was agreed that if the timber was destroyed before cutting, any benefit to *X* of relief from its obligations to the Forest Service would be passed on to *LP* through a reduction in the purchase price from *A*.

In addition, *X* agreed to continue dealing with the Forest Service with respect to the contracts on behalf of *A* and *LP*. *X* agreed to perform for *LP*, in exchange for consideration, services generally co-extensive with its obligations under the contract with the Forest Service. Also, *X* agreed to act for *LP* (1) as timber manager, supervising the cutting of the timber, and (2) as sales agent, arranging log sales.

LAW AND ANALYSIS

Section 163 of the Code allows as a deduction all interest paid or accrued within the taxable year on indebtedness.

Interest within the meaning of section 163 of the Code is a charge for the use or forebearance of money. *Deputy v. Dupont*, 308 U.S. 488 (1940). An indebtedness, for purposes of section 163, is an unconditional and legally enforceable obligation for the payment of money. See *Autenreith v. Commissioner*, 115 F.2d 856 (3rd Cir. 1940).

Where property is purchased with the purchase price to be paid in installments, the obligation to make the installment payments normally constitutes the type of indebtedness that will support an interest deduction. However, it is the nature of the payment made and not the label affixed by the parties that is controlling. *Autenreith*, *supra*. In determining whether a payment constitutes interest on indebtedness, economic realities govern over the form in which a transaction is cast. *Titcher v. Commissioner*, 57 T.C. 315 (1971). Therefore, a payment designated as interest by the parties may be recharacterized if, economically, it constitutes part of the purchase price of the property. *LaCroix v. Commissioner*, 61 T.C. 471 (1974).

In the instant case, the economic reality of the transaction is that the 8*x* dollars designated as interest is part of the purchase price of the timber to *LP*. This is so because *LP*'s right to the timber derives only from *X*'s right. *X*, in turn, did not have title to the timber, but rather had the right to cut any time within the applicable period. For this right *X* agreed to pay an estimated additional 22*x* dollars on an "as-cut" basis, with adjustments based on volume of timber cut. Thus, it can be concluded that *LP* was not purchasing timber from either *X* or *A*, but was purchasing timber through *X* from the Forest Service on the same terms agreed to by *X*. Furthermore, the value of the contract right *LP* purchased from *A* cannot have been greater than 1*x* dollars, the total excess of payments made by *LP* over the payments that *X* was obligated to pay to the Forest Service. In essence, *LP* paid 1*x* dollars to put itself in the same position as *X*—i.e., in the position to receive the timber as cut and when paid for. The timing and amount of *LP*'s payments are set to coincide with *X*'s payments to the Forest Service. If the timber is destroyed before cutting, *X*'s reduction in price is passed on to *LP*. The amount of *LP*'s payments are adjustable based on the amount of timber actually cut during the year. Accordingly, *LP*'s payments should be regarded as the same as *X*'s—payments for the timber as it is cut. Since *X* had the right to cut at any time, the 23*x* dollars, representing the estimated total potential payment by *X*, did not include a charge for the use or forebearance of money. The additional 1*x* dollars paid to *A* to compensate it for the assignment fee paid to *X* should be regarded as a cost of the rights received by *LP*.

HOLDING

The 8*x* dollar payment is not deductible as interest under section 163 of the Code.

---

26 CFR 1.163-1: Interest deduction in general.

Mortgage interest; payments by parents to student-child. Parents "loaned" money to their student-child in return for the child's non-interest bearing demand note. Several days later, as previously agreed, the child "loaned" the money back to the parents in exchange for a mortgage note on their home. The "interest" payments to the child on the note are not deductible since no true debtor-creditor relationship existed.

Rev. Rul. 82-94

ISSUE

Are the parents of a college student allowed to deduct as interest under section 163(a) of the Internal Revenue Code monthly payments to their child made pursuant to a mortgage obligation under the circumstances described below?

FACTS

A is a full time student at *X* university. The cost of tuition, fees, books, room and board at *X* for an academic year is about $8,000.

On January 2, 1980, *B* and *C*, the parents of *A*, loaned *A* $50,000 with the stipulation that *A* would loan the entire $50,000 back to *B* and *C*. The loan to *A* was evidenced by *A*'s non-interest bearing demand note. Several days later *A* returned the $50,000 to *B* and *C* in exchange for their $50,000 principal amount note which was secured by a mortgage on their personal residence. The mortgage note provided for stated interest of 17 percent, and required monthly payments of $730 for a period of 20 years.

During 1980 *B* and *C* made payments on the mortgage note to *A* totaling $8,760. $60 of those payments was deemed to be a repayment of principal. *A* used the funds to pay the expenses incurred while attending *X*. *B* and *C* filed a joint federal income tax return for 1980 and claimed as an itemized deduction interest payments of $8,700 on the mortgage note. *A*'s 1980 federal income tax return included a Schedule C that showed that *A* was in the mortgage loan business. The only item shown on the Schedule C was income of $8,700 from the conduct of that business.

LAW AND ANALYSIS

Section 163(a) of the Code allows a deduction for all interest paid or accrued within the taxable year on indebtedness.

The term "interest on indebtedness" has been construed as meaning "compensation for the use or forbearance of money." *Deputy v. du Pont*, 308 U.S. 488, 498 (1940), Ct.D. 1435, 1940-1 C.B. 118.

In order for interest to be deductible under section 163(a) there must be valid indebtedness. *See Knetsch v. Commissioner*, 364 U.S. 361 (1960), Ct.D. 1858, 1961-1 C.B. 34. The existence of a valid indebtedness is determined by "not whether the individual steps necessary to establish a formalistic debtor-creditor relationship were undertaken but whether when the transaction is considered as a whole and realistically, there was in substance a debtor-creditor relationship." *Rubin v. United States*, 304 F.2d 766, 769 (7th Cir. 1962).

The transactions undertaken by *B* and *C* are analogous to those in *Perrett v. Commissioner*, 74 T.C. 111 (1980). In *Perrett*, the taxpayer and his business partner each loaned a large sum of money to separate trusts established for the benefit of their respective children. The money was soon thereafter borrowed from the trusts by the partnership. The taxpayer and his partner contended that they were entitled to deduct their respective share of the amounts paid by the partnership to the trusts as "interest". The court, upon concluding that the series of loans served no purpose other than allowing the partners to make contributions (through the partnership) to their children's trusts, which they would deduct as interest, held that the amounts paid by the taxpayer's partnership to the trusts were not deductible as interest because the transactions were not in substance loans. *Perrett v. Commissioner, supra* at 134.

In the present case, *B* and *C* transferred $50,000 to *A* with the understanding that the entire amount would be returned to them shortly thereafter. There is no economic reality or significance to the exchange of obligations and circular flow of the $50,000, apart from the attempt to deduct the cost of *A*'s college education as an interest deduction. For federal tax purposes, no true debtor-creditor relationship existed between the parties. Accordingly, no tax deduction is allowable for any amount labeled as interest on the artifically-created indebtedness.

HOLDING

B and *C* are not allowed to deduct as interest under section 163(a) of the Code any amounts paid to *A* pursuant to the mortgage note they gave to *A*.

Further, *A* would not include the $8,700 of payments in gross income.

Section 165.—Losses

26 CFR 1.165-1: Losses.
(Also Section 62; 1.62-1.)

Losses; penalties for premature withdrawal of funds; time savings account. Penalties for premature withdrawal of funds from a time savings account, including amounts that exceed interest accrued or already paid on the account, are allowable deductions under section 165 of the Code in arriving at adjusted gross income.

Rev. Rul. 82-27

ISSUE

Are penalties for premature withdrawal of funds from a time savings account deductible pursuant to section 165 of the Internal Revenue Code under the circumstances described below?

FACTS

In December 1980, *A*, an individual who uses the cash receipts and disbursements method of accounting, deposited 300*x* dollars in a 12-month time savings account in bank *BK*. This deposit was in no way connected with any trade or business of *A*'s. In 1980, *A* received 2*x* dollars interest from *BK* and reported that amount on *A*'s Form 1040, U.S. Individual Income Tax Return for that year. In January 1981, *A* withdrew the entire amount of the time savings account from *BK* less a penalty of 6*x* dollars for premature withdrawal. At the time of withdrawal 2*x* dollars of interest had accrued for 1981 on *A*'s account.

12 C.F.R. section 1204.103 (1980) of the Depository Institutions Deregulation Committee Regulations provides rules relating to premature withdrawal of funds from time deposits. In the past, the penalty could not exceed interest accrued or already paid on the account. Under the current regulations the penalty may exceed interest accrued or already paid and require a forfeiture of principal.

LAW

Section 62(12) of the Code provides that adjusted gross income means, in the case of an individual, gross income minus the deductions allowed by section 165 for losses incurred in any transaction entered into for profit, though not connected with a trade or business, to the extent that such losses include amounts forfeited to a bank, mutual savings bank, savings and loan association, building and loan association, cooperative bank, or homestead association as a penalty for early withdrawal of funds from a time savings account, certificate of deposit, or similar class of deposits.

Section 165(c)(2) of the Code provides a deduction for any loss sustained during the taxable year and not compensated for by insurance or otherwise, including losses incurred in any transaction entered into for profit, though not connected with a trade or business.

HOLDING

The 6*x* dollars paid by *A* as a penalty for premature withdrawal of funds from *A*'s time savings account is an allowable deduction under section 165 of the Code in arriving at *A*'s adjusted gross income for 1981. In addition, the
2*x* dollars of accrued interest in 1981
includible in *A*'s gross income for th
year. *A*, however, may use the Mod
fied Income and Loss (Forfeitur
method set forth in Rev. Rul. 75-2
1975-1 C.B. 367, if *BK* uses th
method of reporting on the For
1099-INT (Statement for Recipients
Interest Income) it furnishes *A* fo
1981.

---

26 CFR 1.165-1: Losses.

Losses; rice growers. Rice growers who have a basis in their rice history acreage are entitled to a loss deduction to the extent of their basis effective December 22, 1981.

Rev. Rul. 82-67 [1]

FACTS

Section 601 of the Agriculture and Food Act of 1981, Pub. L. No. 97-98, 97th Cong., 1st Sess. (December 22, 1981), repeals those provisions of the Agricultural Adjustment Act of 1938, as amended, relating to rice history acreage. This legislation eliminates rice history acreage beginning with the 1982 rice crop year as the basis for distributing yearly federal benefits to rice growers.

HOLDING

Provided that rice growers can establish a basis in their rice history acreage, they are entitled to a loss deduction to the extent of their basis under section 165 of the Internal Revenue Code. This loss, if any, occurred on December 22, 1981, the effective date of the Act.

---

26 CFR 1.165-1: Losses.

Whether a taxpayer that burns down a building and receives insurance proceeds is entitled to a loss deduction under section 165 of the Code in the following year upon repayment of the proceeds to the insurance company. See Rev. Rul. 82-74, page 110.

---

[1] Also released as News Release IR-82-42, dated April 1, 1982.

Section 166.—Bad Debts

26 CFR 1.166-4: Reserve for bad debts.

Change of method of accounting for bad debts from the specific charge-off method to the reserve method. See Rev. Proc. 82-19, page 465.

Section 167.—Depreciation

26 CFR 1.167(a)-1: Depreciation in general.

Whether the cost of replacing telephone wires with buried cable is to be currently expensed as a repair under section 162(a) of the Code or capitalized under section 263(a) and depreciated over its useful life under section 167(a). See Rev. Rul. 82-12, page 52.

---

26 CFR 1.167(a)-11: Depreciation based on class lives and asset depreciation ranges for property placed in service after December 31, 1970.
(Also Section 57; 1.57-1.)

Depreciation; CLADR; tax preference. The selection of any asset depreciation period for the assets in a vintage account in accordance with section 1.167(a)-11 (CLADR system) of the regulations is binding on the taxpayer. Thus, this selection may not be changed to increase the guideline life in order to eliminate the tax preference item that results from the 20% "bonus depreciation."

Rev. Rul. 82-22

ISSUE

Under the circumstances described below, may a taxpayer change an asset depreciation period selected under the provisions of the Class Life Asset Depreciation Range (CLADR) system of section 1.167(a)-11 of the Income Tax Regulations?

FACTS

In 1975, a taxpayer placed in service and conveyed by lease the right to use an ocean-going vessel. The taxpayer elected the CLADR system under section 1.167(a)-11 of the regulations. The taxpayer placed the vessel in asset guideline class 00.28, selected from the asset depreciation range the lower limit of 14½ years as an asset depreciation period, and chose to compute depreciation by the declining balance method using 200 percent of the straight line rate.

An amendment to section 57(a)(3) of the Internal Revenue Code, which was made by section 301(c) of the Tax Reform Act of 1976, expanded the definition of accelerated depreciation as an item of tax preference. Under section 57(a)(3), as amended, accelerated depreciation includes (1) acceleration in depreciation resulting from using an accelerated method of depreciation, as compared to a straight line method, and (2) acceleration resulting from selecting an allowable asset depreciation period that is less than the asset guideline period (the mid-point of the asset depreciation range).

To mitigate the effect of this change in the Code, the taxpayer, pursuant to section 1.167(a)-11(c)(1)(iii) of the regulations, changed in 1977 from the declining balance method to the straight line method, thereby eliminating the portion of the tax preference item that had resulted from the accelerated method of depreciation. However, the taxpayer continued to have a tax preference item of the amount by which the allowable depreciation under the straight line method, using a 14½-year asset depreciation period, exceeded depreciation under the straight line method using an 18-year asset depreciation period (the asset guideline period for asset guideline class 00.28).

The taxpayer now seeks to modify its CLADR election by changing the asset depreciation period from 14½ to 18 years, thereby further reducing accelerated depreciation as a tax preference item.

LAW AND ANALYSIS

Section 1.167(a)-11(a)(1) of the regulations provides that a taxpayer may not apply the CLADR system unless it makes an election and thereby consents to and agrees to apply all of the provisions of the section. One of these provisions is that the taxpayer's election, made with the return for the taxable year, may not be revoked or modified.

Section 1.167(a)-11(b)(5)(i) of the regulations describes the requirements of the election and provides that, with limited exceptions not applicable to this situation, a taxpayer's election to apply this section may not be revoked or modified after the last day prescribed for filing the election. Thus, for example, after that day, a taxpayer may not cease to apply this section to property included in the election, establish different vintage accounts for the taxable year of election, select a different period from the asset depreciation range for any account, or adopt a different first-year convention for any account. See also section 1.167(a)-11(f)(3) of the regulations.

If a taxpayer elects the CLADR system the taxpayer is bound by all of the prescribed accounting and reporting rules. Although section 1.167(a)-11(c)(1)(iii) provides permission for limited changes of method of depreciation, section 1.167(a)-11 specifically prohibits any change in the guideline depreciation period originally claimed by the taxpayer.

HOLDING

Under the circumstances described above, the taxpayer may not change an asset depreciation period selected under the provisions of the CLADR system of section 1.167(a)-11 of the regulations.

---

26 CFR 1.167(a)-11: Depreciation based on class lives and asset depreciation ranges for property placed in service after December 31, 1970.

Depreciation; CLADR; half-year conventions for partnerships. For property placed in service before November 15, 1979, the date that the partnership begins to incur expenses and receive income is the commencement date of the partnership's initial taxable year for purposes of applying the half-year conventions provided by section 1.167(a)-11(c)(2) of the regulations.

Rev. Rul. 82-110

ISSUE

When does a partnership's initial taxable year begin for purposes of applying the half-year conventions provided by section 1.167(a)-11(c)(2) of the Income Tax Regulations?

FACTS

The organization was formed as a

trust under state law pursuant to a trust agreement executed on December 15, 1977, and is classified as a partnership under section 7701(a)(2) of the Internal Revenue Code.

The partnership was organized to acquire and hold title to an ocean going oil tanker for lease (charter) to a pre-designated third party. The partnership reports income and expenses under the cash method of accounting and files its return on a calendar year basis. The partnership has elected to use the Class Life Asset Depreciation Range (CLADR) system for depreciation, adopting the half-year convention provided in section 1.167(a)-11(c)(2)(iii) of the regulations.

On December 20, 1978, over a year after the trust agreement was executed, the oil tanker was purchased for a price of $42,000,000. Prior to the acquisition of the oil tanker, the partnership received no income and had no deductible expenses.

LAW AND ANALYSIS

Section 443(a)(2) of the Internal Revenue Code provides that a return for a period of less than 12 months shall be made when the taxpayer is in existence during only part of what would otherwise be a full taxable year.

Section 706(b)(1) of the Code provides that the taxable year of a partnership shall be determined as though the partnership were a taxpayer.

Section 1.167(a)-11(c)(2)(i) of the regulations provides that the allowance for depreciation of a vintage account (as defined in section 1.167(a)-11(b)(3)) shall be determined by applying one of the conventions described in subdivision (ii) (modified half-year convention) and (iii) (half-year convention) of section 1.167(a)-11(c)(2).

Section 1.167(a)-11(c)(2)(iii) of the regulations provides that the depreciation allowance for a vintage account for which the taxpayer adopts the "half-year convention" shall be determined by treating all property in the account as placed in service on the first day of the second half of the taxable year.

Section 1.167(a)-11(c)(2)(iv)(*b*) of the regulations provides that if the actual number of months in a taxable year is other than 12 full calendar months, depreciation is allowed only for such actual number of months and the terms "taxable year", for purposes of this subparagraph, shall mean only such number of months.

Section 1.167(a)-11(c)(2)(iv)(*c*) of the regulations, which applies to property placed in service after November 14, 1979, provides that, for purposes of the first-year convention, the taxable year of the person placing property in service does not include any month before the month in which the person begins engaging in a trade or business or holding depreciable property for the production of income.

Section 1.167(a)-11(c)(2)(iv) of the regulations is silent on the question when a partnership comes into existence for purposes of applying the half-year convention. This can be determined by analogy to the approach used in determining when a corporation comes into existence.

Prior to its amendment by T.D. 7763 (January 19, 1981), 1981-1 C.B. 80, section 1.167(a)-11(c)(2)(iv) of the regulations did not contain the express rule now stated in subdivision (*c*). An example was provided, however, of how the regulation was to be applied. The example describes a corporation that came into existence within the meaning of section 1.6012-2(a)(2) on September 1st and adopted a taxable year ending on December 31st. The example states that the taxable year consists of 4 months, and for purposes of the half-year convention, the first half of such taxable year ends on October 31st and the second half of such taxable year begins on November 1st. Therefore, to apply either the half-year or the modified half-year convention, it is first necessary to determine when the taxable year begins.

Section 1.6012-2(a)(2) of the regulations requires the filing of a tax return by a corporation for any part of a year in which the corporation is in existence. Therefore, the beginning of the taxable year for a corporation for purposes of section 1.167(a)-11(c) occurs when the corporation comes into existence.

Section 1.6031-1(a)(1) of the regulations provides that, for purposes of filing a partnership return, an unincorporated organization will not be considered, within the meaning of section 761(a) of the Code, to carry on a business, financial operation, or venture as a partnership before the first taxable year in which such organization receives income or incurs any expenditures treated as deductions for federal income tax purposes. Thus, for purposes of section 1.167(a)-11(c)(2)(iv), a partnership does not come into existence until such time as the partnership is required to file a return.

In this case, no income was received or deductible expenses paid or incurred prior to the date that the oil tanker was acquired. Thus, for purposes of 1.167(a)-11(c)(2) of the regulations, the partnership came into existence and the first taxable year began on December 20, 1978, the date on which the oil tanker was acquired and leased.

HOLDING

The commencement date of the partnership's initial taxable year for purposes of applying the half-year conventions. provided by section 1.167(a)-11(c)(2) of the regulations occurred on December 20, 1978, the date that the partnership began to incur expenses and receive income. Therefore, the partnership is entitled to a deduction on its 1978 return for 6 days depreciation. However, for assets placed in service after November 14, 1979, see section 1.167(a)-11(c)(2) as amended by T.D. 7763, which establishes rules based on months and would, if applicable, result in a depreciation deduction for 15 days under the facts in this case.

---

26 CFR 1.167(k)-4: Time and manner of making election.

Depreciation; rehabilitation expenses; low-income rental housing; election. The election of section 167(k)(1) of the Code requires that a positive step must be taken by a taxpayer that makes it possible to determine, without looking beyond the tax return and supporting schedules and statements, that an election is intended, including an identification of the property involved.

Rev. Rul. 82-103

ISSUE

Has the taxpayer made a valid election under section 167(k)(1) of the Internal Revenue Code under the circumstances described below so that accelerated depreciation of rehabilitation expenditures can be claimed?

FACTS

PRS, a limited partnership, was formed to purchase, rehabilitate, and operate on a rental basis an existing apartment complex in a low-income area of a large city. *PRS* incurred rehabilitation expenditures as defined in section 167(k)(1)(3) of the Code. When *PRS* filed its federal income tax return for the first year in which it claimed depreciation for the rehabilitation expenditures, no statement or schedule of any kind was attached mentioning an election to accelerate depreciation under section 167(k)(1). It was not apparent from the return and supporting schedules that *PRS* had actually claimed accelerated depreciation under section 167(k)(1). However, *PRS's* books and records reflected that depreciation attributable to the rehabilitation expenditures had been computed using a straight line method, a 60-month useful life, and no salvage value.

LAW AND ANALYSIS

Section 167(k)(1) of the Code permits a taxpayer to elect, in accordance with regulations prescribed by the Secretary, to compute the depreciation deduction provided by section 167(a) attributable to rehabilitation expenditures incurred with respect to low-income rental housing after July 24, 1969, and before January 1, 1984, under the straight line method using a useful life of 60 months and no salvage value.

Section 1.167(k)-4(a)(1) of the Income Tax Regulations states that an election under section 167(k) of the Code must be made by attaching a statement to the income tax return for the first tax year in which the taxpayer computes the depreciation deduction using a 60-month useful life.

Section 1.167(k)-4(b)(1) of the regulations provides that the election must contain certain information.

In *Tipps v. Commissioner,* 74 T.C. 458 (1980), *acq.,* 1981-1 C.B. 2, the court considered the question of whether certain partnerships had validly elected the benefits of the depreciation method provided by section 167(k)(1) of the Code. The partnerships attached statements to their federal income tax returns for the year of the initial election that included all the required information except for the per-unit information required by the regulations. A statement was included that the information would be available in the partnerships' offices for audit purposes. The court decided that the partnerships had made valid elections.

In reaching its decision, the court in *Tipps* was satisfied that there was substantial compliance with the regulations because it found that the taxpayers had made an election under section 167(k) that bound them and clearly identified the properties and expenditures as to which the election was being made. The court stated that the doctrine of substantial compliance could be used to correct a procedurally imperfect election when the taxpayers had clearly made an attempt to avail themselves of the election.

The *Tipps* decision is distinguishable from the instant case because in *Tipps* the taxpayers made an unequivocal election to be bound by the provisions of section 167(k) of the Code, whereas in the instant case there is no evidence of an unequivocal election under section 167(k).

The requirement of an election under section 167(k)(1) of the Code is a substantive one, and is not merely procedural. The election requirement means that a positive step must be taken by an electing taxpayer that makes it possible to determine, without looking at anything beyond the federal income tax return and supporting schedules and statements, that an election is intended. In addition, the property intended to be covered by the election must be identified. When it is not apparent from the return and schedules that an unequivocal election is intended, as was the case in *Tipps,* the requirement of section 1.167(k)-4(a)(1) of the regulations will not be satisfied.

HOLDING

The taxpayer has not made a valid election under section 167(k)(1) of the Code.

Section 168.—Accelerated Cost Recovery System

26 CFR 5c.168(f)(8)-2: Election to characterize transactions as a section 168(f)(8) lease.
(Also Section 103; 5c.103-2.)

T.D. 7800

TITLE 26.—INTERNAL REVENUE—CHAPTER I, SUBCHAPTER A, PART 5c.—TEMPORARY INCOME TAX REGULATIONS UNDER THE ECONOMIC RECOVERY TAX ACT OF 1981

Special rules for leases concerning qualified mass commuting vehicles and new reporting requirements for all safe harbor leases

AGENCY: Internal Revenue Service, Treasury.
ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations relating to the special rules for leases concerning qualified mass commuting vehicles under the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256]. The regulations provide guidance to persons executing lease agreements concerning qualified mass commuting vehicles under section 168(f)(8) of the Internal Revenue Code of 1954. These regulations also contain a new reporting requirement applicable to all leases qualifying under section 168(f)(8).

DATE: The regulations apply with respect to safe harbor leases executed and certain mass commuting vehicles placed in service after December 31, 1980.

FOR FURTHER INFORMATION CONTACT: John A. Tolleris of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Ave., N.W., Washington, D.C. 20224 (202-566-3294).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains amendments to the Temporary Income Tax Regulations under the Economic Recovery Tax Act of 1981 (26 CFR Part 5c) promulgated by Treasury Decision 7791 [1981-2 C.B. 66] regarding special rules for leases under section 168(f)(8) of the Internal Revenue Code of 1954, which were published in the FEDERAL REGISTER for October 23, 1981 (46 FR 51907). This amendment expands upon those temporary regulations providing rules relating to certain mass commuting vehicles treated as qualified leased property and to a new filing requirement applicable to all safe harbor leases. This amendment will remain in effect until superseded by later final regulations with respect to section 168 concerning the accelerated cost recovery system.

EXPLANATION

This amendment clarifies the special rules for leases with respect to certain mass commuting vehicles under section 168(f)(8)(D)(iii). It establishes certain requirements that must be met by the lessee (usually a State or local governmental unit which operates the local mass transit system) and the lessor in order that the lessor may, for Federal income tax purposes, lease mass commuting vehicles, such as buses and rapid rail cars, and take cost recovery deductions with respect to them.

The lessor is allowed no investment tax credit with respect to mass commuting vehicles. There is no requirement that such vehicles be leased under section 168(f)(8) within 3 months after being placed in service. In general, those portions of vehicles whose financing is allocable to grants from Federal agencies such as the Urban Mass Transportation Administration may not be leased under section 168(f)(8).

A notice of proposed rulemaking proposing a definition of "qualified mass commuting vehicles" under section 103(b)(9) is published in the Proposed Rules section of this issue of the FEDERAL REGISTER [LR-192-81, page 566, this Bulletin].

This amendment also contains a new reporting requirement applicable to all leases qualifying under section 168(f)(8) and executed after December 31, 1981. Basically, the new rule provides that the lessor and lessee are required to file jointly an information return setting forth certain specified information concerning the leasing transaction within a 30-day period after the lease is executed or the election under section 168(f)(8) will be void. A copy of this information return is also required to be attached to the Federal income tax return of the lessor and lessee. For leases executed before January 1, 1982, only the lessor is required to file the information return postmarked by January 31, 1982. Unless the lessor's failure to file is shown to be due to reasonable cause, or unless the lessee files the return postmarked by January 31, 1982, the lessor's failure to timely file is a disqualifying event which may result in a recapture of the tax benefits to the lessor.

INAPPLICABILITY OF EXECUTIVE ORDER 12291

These regulations are not major legislative regulations for purposes of Executive Order 12291 because the economic effect of these regulations flows principally from the statutory provisions upon which these regulations are based.

DRAFTING INFORMATION

The principal author of these regulations is John A. Tolleris of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations on matters of both substance and style.

Adoption of amendments to the regulations

Accordingly, the following amendments to 26 CFR Part 5c are adopted:

Paragraph 1. New §§5c103-2 and 5c.103-3 are added. The new sections read as follows:

§5c.103-2 Leases and industrial development bonds.

For purposes of section 103(b)(2), the determination of whether an obligation constitutes an industrial development bond shall be made without regard to the characterization of the transaction as a lease under section 168(f)(8).

§5c.103-3 Leases and arbitrage.

In the case of a sale and leaseback transaction qualifying under section 168(f)(8), where the lessee's rental payments are substantially equal in timing and amount to the principal and interest payments on the lessor's note, the arbitrage provisions of section 103(c) and §§1.103-13, 1.103-14, and 1.103-15 shall apply to any obligations of the lessee (or party related to the lessee) without regard to the section 168(f)(8) lease transaction.

Par. 2. Section 5c.168(f)(8)-2 is amended by revising paragraph (a)(3) to read as follows:

§5c.168(f)(8)-2 Election to characterize transaction as a section 168(f)(8) lease.

(a) Election. ***

(3) *Information return concerning the election.* (i) Except as provided in subdivision (ii), for each lease agreement, the lessor and lessee must jointly file Form 6793, Safe Harbor Lease Information Return, concerning their election under section 168(f)(8). The information return must be signed by both the lessor and the lessee and filed not later than the 30th day after the agreement is executed with the Commissioner of Internal Revenue, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attn: Form 6793). Unless the failure to file timely is shown to be due to reasonable cause, the failure to file the information return timely shall void the section 168(f)(8) election as of the date of the execution of the lease agreement. The

information return shall include the following items:

(A) The name, address, and taxpayer identifying number of the lessor and the lessee (and the common parent company if a consolidated return is filed);

(B) The service center with which the income tax returns of the lessor and lessee are filed;

(C) A description of each property with respect to which the election is made;

(D) The date on which the lessee places the property in service (determined as defined in §5c.168(f)(8)-6(b)(2)(i)), the date on which the lease begins, and the term of the lease;

(E) The recovery property class of the leased property under section 168(c)(2) (for example, 5 years) and the ADR midpoint life of the leased property;

(F) The terms of the payments between the parties to the lease transaction;

(G) Whether the ACRS deductions and the investment tax credit are allowable to the same taxpayer;

(H) The aggregate amount paid to outside parties to arrange or carry out the transaction, such as, for example, legal and investment banking fees;

(I) For the lessor only: the unadjusted basis of the property as defined in section 168(d)(1);

(J) For the lessor only: if the lessor is a partnership or a grantor trust, the name, address, and taxpayer identifying number of the partners or the beneficiaries, and the Service Center with which the income tax return of each partner or beneficiary is filed; and

(K) Such other information as may be required by the return or its instructions.

The aggregate amount paid to outside parties which is described in subdivision (H) need not be disclosed unless it is reasonable to estimate that either the lessor or the lessee will lease property under section 168(f)(8) for the calendar year which has an aggregate adjusted basis to such person of more than $1,000,000. If either the lessor or the lessee reasonably expects to lease property with an aggregate basis of more than $1,000,000, then both parties must disclose their transaction costs.

(ii) In the case of an agreement executed before January 1, 1982, only the lessor is required to file the information return described in subdivision (i) of this paragraph (a)(3) and the return must be postmarked not later than January 31, 1982. Unless the failure to file timely is shown to be due to reasonable cause, or unless the lessee files the information return postmarked by January 31, 1982, the lessor's failure to file the information return timely shall be a disqualifying event as of February 1, 1982, which shall cause an agreement to cease to be treated as a lease under section 168(f)(8). For the Federal income tax consequences of a disqualifying event, see §5c.168(f)(8)-8.

(iii) A copy of the information return described in subdivisions (i) and (ii) shall be filed by each party with its timely filed Federal income tax return for its taxable year during which the lease term begins. However, for taxable years ending in 1981 with respect to lease agreements executed during calendar year 1981, such statement shall be filed by the later of (A) the due date (taking extensions into account) of the party's 1981 Federal income tax return, or (B) where the filing of an amended return is required, with the amended return within 3 months following the execution of the lease agreement. For the requirement to file an amended return within 3 months and the consequences of the failure to so file, see §5c.168(f)(8)-6(b)(2)(ii). A taxpayer that is required to file the information return with its Federal income tax return before an information return form is available shall file, in lieu of the required information return, a statement which contains the information set forth in subdivisions (A) through (J) of paragraph (b)(3)(i). The failure by the lessor to file the information return (or, if applicable, the statement referred to in the preceding sentence) with its timely filed Federal income tax return shall be a disqualifying event which shall cause an agreement to cease to be treated as a lease under section 168(f)(8). For the Federal income tax consequences of a disqualifying event, see §5c.168(f)(8)-8.

* * * * *

Par. 3. Section 5c.168(f)(8)-6 is amended by revising paragraphs (a)(2)(ii) and (b)(3) to read as follows:

§5c.168(f)(8)-6 Qualified leased property.

(a) *Basic rules.* ***

(2) *Sale and leaseback arrangement.* ***

(ii) For purposes of this subparagraph (2) and paragraphs (b)(3)(ii) of this section, transactional costs with respect to a sale and leaseback arrangement that are not currently deductible shall be allocated to the lease agreement (and not included in the lessor's adjusted basis with respect to the property) and amortized over the term of the lease. These costs include legal and investment banking fees and printing costs.

* * * * *

(b) *Special rules.* ***

(3) *Qualified mass commuting vehicle.* (i) A qualified mass commuting vehicle as defined in section 103(b)(9) will constitute qualified leased property for purposes of section 168(f)(8)(D)(iii) and this section provided all of the following requirements are met:

(A) At least part (as, for example, 5 percent) of the financing for the purchase of such vehicle must be derived from proceeds of obligations the interest on which is excludable from income under section 103(a)(1) (whether or not such obligations are described in section 103(b)(4)(I));

(B) The vehicle must be recovery property (*i.e.*, it must have been first placed in service by the lessee after December 31, 1980); and

(C) The vehicle must not have been previously leased under a section 168(f)(8) lease by the lessee.

A qualified mass commuting vehicle that is qualified leased property may be leased under section 168(f)(8) at any time after December 31, 1980. The requirement of subdivision (A) may be satisfied where the vehicles leased under a section 168(f)(8) lease are refinanced with proceeds of an obligation the interest on which is excludable from income under section 103(a)(1).

(ii) Where the leased property is purchased, directly or indirectly, by the lessor from the lessee (or a party related to the lessee), the property will not qualify under this subsection unless the lessor's adjusted basis in the property does not exceed the adjusted basis of the lessee (or related party) at the time of the execution of the lease. The adjusted basis of property to a lessee (or related party) shall be determined under part II of subchapter O of chapter 1 of the Code for purposes of determining gain, except that the adjustment described in section 1016(a)(3) and §1.1016-4 need not be made for property acquired during calendar year 1981 and leased no later than March 1, 1982.

(iii) In a transaction characterized as a lease under section 168(f)(8), the lessor's adjusted basis may not include that portion, if any, of the cost of the vehicle to the lessee (or related party) that is financed, directly or indirectly, with an Urban Mass Transportation Administration (UMTA) grant (excluding a grant under the interstate transfer provision of the Federal-Aid Highway Act (FAHA)), a FAHA grant, or any other Federal grant. Where a vehicle is included as part of an UMTA-funded project, 80 percent of the vehicle's cost will be deemed to be financed with an UMTA grant and 20 percent will be deemed to be financed from non-Federal sources without regard to whether the UMTA funds or the non-Federal funds are traceable to any particular vehicle included within the project. For purposes of this subdivision and subdivision (ii), amounts originating from non-Federal sources which are paid or incurred with respect to leased property by a State or political subdivision of the State (or political subdivision created by the joint authorization of two or more States) shall be taken into account in computing the lessee's adjusted basis in the leased property as if the lessee had paid or incurred such amounts.

(iv) If a vehicle is purchased pending approval of an UMTA grant, the lessor's unadjusted basis in the vehicle may equal the lessee's unadjusted basis unreduced by any subsequently approved UMTA grant; however, if an UMTA grant is later approved and the vehicle is included as part of an UMTA-funded project, except as provided hereinafter in this subdivision (iv), the lease shall terminate with respect to an undivided 80 percent interest in the vehicle. For the Federal income tax consequences of the termination of a lease, see §5c.168(f)(8)-8. If such a subsequently approved UMTA grant is used to purchase additional qualified mass commuting vehicles, the portion of each vehicle deemed to be allocable to non-UMTA financing (*i.e.*, 20 percent) may be leased under section 168(f)(8). If a vehicle is purchased pending approval of an UMTA grant and leased under section 168(f)(8), the lease will not be deemed to have terminated with respect to 80 percent of the vehicle when the UMTA grant is later approved if the total interest leased before the grant is approved did not exceed 20 percent of the lessee's adjusted basis in the vehicle (unadjusted basis prior to March 1, 1982) unreduced by any subsequently approved UMTA grant. For purposes of this subdivision and subdivision (iii), the allocation principles applicable to UMTA grants shall apply in the case of FAHA grants except that 85 percent and 15 percent shall be substituted for 80 percent and 20 percent, respectively. Similar allocation rules shall also apply to other Federal grants used to finance the acquisition of qualified mass commuting vehicles.

(v) (A) Notwithstanding the provisions of §5c.168(f)(8)-2(a)(3)(iii), the lessee in a transaction to which this paragraph (b)(3) applies is not required to file an information return or a statement concerning its election under section 168(f)(8).

(B) Notwithstanding the provisions of §5c.168(f)(8)-2(a)(5), if the transfer of a qualified mass commuting vehicle is not otherwise a disqualifying event, the transferee is not required to file the statement mentioned therein.

(C) The fact that a qualified mass commuting vehicle is not section 38 property because it is used by an exempt entity will not disqualify the lease under §5c.168(f)(8)-8(b)(4); however, a disqualifying event will occur, and the agreement will cease to be characterized as a lease under section 168(f)(8), with respect to a vehicle which (*1*) ceases to be a qualified mass commuting vehicle or (*2*) would cease to be section 38 property if used by a taxable entity as, for example, a vehicle used predominantly outside the United States. For the Federal income tax consequences of a disqualifying event, see §5c.168(f)(8)-8.

(vi) The lessor of a qualified vehicle will not be allowed an investment tax credit with respect to it under section 38.

(vii) The application of this paragraph (b)(3) may be illustrated by the following examples:

Example (1). On July 1, 1981, a unit of city X, X Transit Authority (XTA), purchases 100 buses after receiving an UMTA grant for 80 percent of their purchase price. Fifteen percent of the purchase price is financed with a combination of State and local governmental grants and 5 percent is financed with proceeds from an issue of tax-exempt obligations described in section 103(b)(4)(I). Because UMTA financed an 80 percent interest in the 100 buses, XTA may lease under section 168(f)(8) only a 20 percent interest in each bus. If XTA were to lease 100 percent of 20 buses, only 20 percent of such buses would be deemed to be leased under a safe harbor lease.

Example (2). The facts are the same as in example (1) except that UMTA has not yet approved XTA's application in 1981. Pending the UMTA approval, XTA purchases and places in service 20 buses in July 1981. The 20 buses are financed with tax-exempt obligations described in section 103(b)(4)(I). On December 15, 1981, XTA sells a 100 percent interest in these 20 buses to Corporation M and leases them back under a lease in which the parties elect to have the provisions of section 168(f)(8) apply. M is a calendar-year taxpayer and claims an ACRS deduction with respect to the buses on its return for taxable year 1981. On July 1, 1982, UMTA approves XTA's grant application, thus enabling XTA to purchase an additional 80 buses. Because 80 percent of the original 20 buses are deemed to have been financed by UMTA beginning on July 1, 1982, the safe harbor lease terminates with respect to an undivided 80 percent interest in the 20 buses. If XTA would be considered the owner of the buses without regard to section 168(f)(8), the termination will result in a deemed sale of an undivided 80 percent interest in the 20 buses by M to XTA. The amount realized by M on the sale will include a proportionate part of the outstanding amount of M's debt plus the sum of any other consideration received by M. M will realize gain or loss, depending upon its basis, with applicable section 1245 recapture. However, XTA may lease the 20 percent interest in the 80 new buses it purchased in 1982 which is deemed to have been financed with non-Federal funds.

Example (3). The facts are the same as in example (2) except that the grant approved by UMTA is used to purchase and renovate a bus garage facility. Eighty percent of the original 20 buses are deemed to have been financed by UMTA beginning on July 1, 1982. The lease would still terminate with respect to an undivided 80 percent interest in the vehicles. XTA cannot lease the garage facility under 168(f)(8) because it does not constitute a qualified mass commuting vehicle.

Example (4). The facts are the same as in example (2) except that on December 15, 1981, XTA sells and leases back only a 20 percent interest in the 20 buses acquired in July 1981. When the UMTA grant is later approved, the lease will not terminate with respect to any portion of the 20 buses. In addition, XTA may lease the 20 percent interest in the 80 new buses purchased in 1982 and deemed to have been financed with non-Federal funds.

Example (5). On August 1, 1982, UMTA approves a grant for a major 5-year capital expenditure program to improve city Y's rapid rail transit system. None of the funds relating to this UMTA-funded project, provided either by UMTA or by city Y, will be used to purchase qualified mass commuting vehicles. Instead, a number of rapid rail cars and buses will be purchased entirely with funds provided with a combination of grants by the State and city governments and of proceeds from an issue of tax-exempt obligations described in section 103(a). Because none of the rapid rail cars and buses are included as part of the UMTA-funded project, no part of them is deemed to be financed by UMTA. If at least 5 percent of the cost of the qualified mass commuting vehicles is provided by tax exempt obligations under section 103(a), the vehicles will be qualified leased property in their entirety.

Example (6). City Z has a mass transit agency (ZTA) which purchases on July 1, 1982, 10 buses for which it pays $1,000,000, 95 percent of which is derived from grants from city Z and 5 percent from tax exempt obligations described in section 103(a). The buses have a useful life within the meaning of §1.167(a)-1(b) of 10 years and their salvage value is zero. On July 1, 1983, ZTA sells these buses to corporation P and leases them back in a transaction which the parties elect to have treated as a lease under section 168(f)(8). At the time of the sale and leaseback, ZTA's adjusted basis in the 10 buses under section 1016(a)(3) and §1.1016-4 is $900,000 ($1,000,000 cost less $100,000 of depreciation sustained, computed on a straight-line basis). Before the transaction will qualify under section 168(f)(8) and §5c.168(f)(8)-6(b)(3)(ii), P's adjusted basis in the vehicles may not exceed ZTA's basis, or $900,000. Assuming that the transaction qualifies under section 168(f)(8) and that corporation P is a calendar year taxpayer, P may claim ACRS deductions for 1982 of $135,000 (15 percent of $900,000).

Example (7). The facts are the same as in example (6) except that the sale and leaseback transaction is closed on December 31, 1982. P's adjusted basis in the vehicles may not exceed ZTA's basis, or $950,000 ($1,000,000 cost less $50,000 of depreciation sustained, computed on a straight-line basis).

Example (8). The facts are the same as in example (6) except that ZTA purchases the buses on June 1, 1981, and enters into the sale and leaseback transaction with corporation P on December 31, 1981. Under §5c.168(f)(8)-6(b)(3)(ii), no adjustment is made to ZTA's basis in the buses for depreciation sustained. Therefore, P's basis in the buses may equal ZTA's cost of $1,000,000.

Example (9). On July 1, 1981, a unit of city W, W Transit Authority (WTA), purchases 100 buses with local grants derived entirely from a city W sales tax. The buses do not constitute qualified leased property under §5c.168(f)(8)-6(b)(3) because no part of the financing for their purchase was derived from the proceeds of tax exempt obligations.

Example (10). The facts are the same as in example (9) except that on November 1, 1981, WTA borrows 5 percent of the cost of the buses and pledges them as security. The interest on WTA's obligation is excludable from income under section 103(a)(1). On December 31, 1981, WTA sells to T Corp. all 100 buses and leases them back. Under §5c.168(f)(8)-6(f)(3)(i), each bus is deemed to be financed with the proceeds of tax exempt obligations. Therefore, if the vehicles otherwise meet the definition of qualified leased property, all the vehicles will be qualified leased property under this section.

* * * * *

Par. 4. Section 5c.168(f)(8)-8(b) is amended by revising subparagraph (2) and by adding new subparagraphs (13) and (14). The revised and added provisions read as follows:

§5c.168(f)(8)-8 Loss of section 168(f)(8) protection; recapture.

* * * * *

(b) *Events which cause an agreement to cease to be characterized as a lease.* ***

(2) The failure by the lessor to file a copy of the information return (or applicable statement) with its income tax return as required in §5c.168(f)(8)-2(a)(3)(iii).***

(13) The property is leased under the provisions of section 168(f)(8)(D)(iii) and §5c.168(f)(8)-6(b)(3) and ceases to be a qualified mass commuting vehicle.

(14) The failure by the lessor to file the required information return described in §5c.168(f)(8)-2(a)(3)(ii) by January 31, 1982, unless the lessee files such return by January 31, 1982.

* * * * *

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue it with notice and public procedure under subsection (b) of section 553 of title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under authority contained in section 168(f)(8)(G) and 7805 of the Internal Revenue Code of 1954 (95 Stat. 216, 26 U.S.C. 168(f)(8)(G); and 68A Stat. 917, 26 U.S.C. 7805).

ROSCOE L. EGGER, JR.,
Commissioner of
Internal Revenue.

Approved December 28, 1981.

JOHN E. CHAPOTON,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on December 28, 1981, 5:03 p.m., and published in the issue of the Federal Register for December 31, 1981, 46 F.R. 63256)

Section 170.—Charitable, Etc., Contributions And Gifts

26 CFR 1.170A-4: Reduction in amount of charitable contributions of certain appreciated property.
(Also Sections 612, 1221, 1231; 1.612-4; 1.1221-1, 1.1231-1.)

Charitable contributions; intangible drilling and development costs. The taxpayer donated to an educational institution certain items obtained in the course of drilling oil and gas wells. The items come within the definition of ordinary income property in section 1.170A-4(b)(1) of the regulations. The taxpayer previously deducted the costs of obtaining the items as intangible drilling and development costs and has a zero basis in them. Therefore, the taxpayer's charitable contribution deduction is zero.

Rev. Rul. 82-9

ISSUE

Under the described circumstances, may a taxpayer take a charitable contribution deduction for donating to an educational institution items obtained in the course of drilling oil and gas wells?

FACTS

The taxpayer, a company engaged in exploring for, developing, refining, and marketing oil and gas, owned certain items held for more than a year. These items, consisting of several thousand samples of well cuttings in boxes and glass vials, 10,000 scout tickets on drilled wells, and 1,000 electrical well logs, were donated to an educational institution described in section 170(c) of the Internal Revenue

Code. In previous tax years, the taxpayer had deducted as intangible drilling and development costs under section 1.612-4 of the Income Tax Regulations all the direct costs of these items and the well logging service, as well as the other costs incurred in drilling the wells.

Well cuttings are fragments of rock that are cut from subsurface formations by the chipping, cutting, and abrasive action of the drilling bit during drilling operations. The cuttings are collected at regular intervals, washed, dried, and placed in separate sample containers and labeled as to geographic location, well name and number, and sample depth. By examining well cutting samples, the character of the rock and depth of the formation penetrated in the course of drilling the well can be determined.

The scout tickets are written summaries of the events occurring during the well drilling operations and usually include data such as the type of rock formations penetrated and their oil or gas producing potential.

An electrical well log is a continuous graphic record of the electrical properties of rock strata that is made by inserting electrodes into the uncased well bore and making a traverse of the strata penetrated by the drilling bit. It permits a determination of the character of the rock, the thickness, and the fluid content of the strata penetrated by the drilling bit, and is also useful in correlating strata from well to well.

LAW AND ANALYSIS

Section 170(a)(1) of the Code allows a deduction for any charitable contribution as defined in section 170(c).

Section 170(e)(1) of the Code and section 1.170A-4(a)(1) of the regulations require that, if a corporation contributes ordinary income property to a charitable organization, the amount of a charitable contribution that would otherwise be deductible under section 170(a) must be reduced by the amount of gain that would not have been long-term capital gain if the property had been sold by the donor at its fair market value when it was contributed.

Section 1.170A-4(b)(1) of the regulations defines the term "ordinary income property" as property any portion of the gain on which would not have been long-term capital gain if the property had been sold by the donor at its fair market value when it was contributed. The term "ordinary income property" includes, for example, letters and memorandums prepared by or for the donor. Having been held for more than a year, the well cuttings, scout tickets, and electric well logs are "ordinary income property" unless, in the hands of the taxpayer, these items are either "capital assets" as defined in section 1221 of the Code or "property used in the trade or business" as defined in section 1231.

Although section 1221 of the Code defines the term "capital asset" as property held by the taxpayer (whether or not connected with the taxpayer's trade or business), section 1221(3)(B) excludes from the term "capital asset" a letter or memorandum, or similar property, held by a taxpayer for whom such property was prepared or produced. The well cutting samples, scout tickets, and electrical well logs are property prepared or produced for the taxpayer whether the taxpayer's employees prepare or produce them or the taxpayer contracts with a third party to produce them.

Section 1.1221-1(c)(2) of the regulations includes in the term "similar property" drafts of speeches, manuscripts, research papers, oral recordings of any type, transcripts of oral recordings, transcripts of oral interviews or dictations, personal or business diaries, logs or journals, corporate archives, including corporate charters, office correspondence, financial records, drawings, photographs, or dispatches.

The electrical well logs are graphic records or logs. The well cutting samples are actual fragments of the formations penetrated, but once labeled and indexed, are, nonetheless, logs or records of strata encountered in wells. The scout tickets are written well histories. As records, logs, or histories prepared for the taxpayer, the electrical well logs, well cutting samples, and scout tickets are substantially similar to memorandums or such similar property as business diaries, logs or journals, office correspondence, drawings, or photographs described in section 1.1221-1(c)(2) of the regulations. Thus, the electric well logs, well cutting samples, and the scout tickets are "similar property" within the meaning of section 1221(3)(B) of the Code.

Although section 1231(b) of the Code defines the term "property used in the trade or business" as property used in the trade or business of a character that is subject to the depreciation allowance provided in section 167, held for more than one year, and real property used in the trade or business, held for more than one year, section 1231(b)(1)(C) excludes from the term "property used in the trade or business" a letter or memorandum, or similar property, held by a taxpayer for whom such property was prepared or produced. Therefore, the contributed items are excluded from the term "property used in the trade or business" because, irrespective of whether or not the items are property that is either subject to the allowance for depreciation or real property, the items are a letter of memorandum, or similar property, held by a taxpayer for whom such property was produced.

The contributed items are excluded from the term "capital asset" by section 1221(3)(B) of the Code and section 1.1221-1(c)(2) of the regulations and are excluded from the term "property used in the trade or business" by section 1231(b)(1)(C). Therefore, the items come within the definition of ordinary income property in section 1.170A-4(b)(1) of the regulations. If the items had been sold by the donor at their fair market value at the time they were contributed to the educational institution, any gain realized would have been recognized as ordinary income. Furthermore, since the costs relating to the donated items had been expensed in tax years before the year of donation, the items have a zero basis in the hands of the donor. Therefore, the entire amount received from a sale of the donated items would have been ordinary income and would reduce the deductible contribution to zero.

HOLDING

Under the described circumstances, the taxpayer may not take a charitable contribution deduction for the contribution of the well cuttings, scout tickets, and electrical well logs.

---

26 CFR 1.170A-4A: Special rule for the deduction of certain charitable contributions of inventory and other property.

T.D. 7807

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Special rule for the deduction of certain charitable contributions of inventory and other property

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final Income Tax Regulations relating to a special rule for the deduction by corporations of certain charitable contributions of inventory and other property as added by the Tax Reform Act of 1976 [Pub. L. 94-445, 1976-3 C.B. (Vol. 1) 1]. The regulations provide corporate donors and charitable and other recipient organizations with the guidance needed to comply with the new law.

DATES: The regulations are effective, generally, with respect to qualified contributions made after October 4, 1976.

FOR FURTHER INFORMATION CONTACT: Charles Saverude of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Ave., N.W., Washington, D.C. 20224 (Attention: CC:LR:T, 202-566-3323).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On March 20, 1980, the FEDERAL REGISTER published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 170(e)(3) of the Code. A public hearing was held on July 15, 1980. After consideration of all comments regarding the proposed amendments, those amendments are adopted as revised by this Treasury decision.

The effectiveness of these regulations will be evaluated on the basis of comments and information received from the public, members of Congress, other Government agencies, and offices within the Treasury Department and Internal Revenue Service.

EXPLANATION OF PROVISIONS: QUALIFIED CONTRIBUTIONS

Section 2135 of the Tax Reform Act of 1976 added a new paragraph (3) to section 170(e) of the Internal Revenue Code to provide a special rule for the deduction by corporation of qualified contributions of certain property. The final regulations provide rules which set forth the requirements for a qualified contribution. Only certain of the organizations described in section 501(c)(3) of the Code may receive the contribution, and only certain property may be contributed (principally inventory and depreciable property). The property must be used for a purpose related to the grounds for the exemption of the organization to which the contribution is made and must be used for the care of the ill, needy, or infants. In addition, the organization may not charge for the transfer (or use) of the property and must provide the corporate-donor with a written statement representing that the organization intends to comply with these restrictions on use and transfer of the property. Finally, the contributed property must conform to any applicable provisions of the Federal Food, Drug, and Cosmetic Act (as amended), and the regulations thereunder, at the date of contribution and for the immediately preceding 180 days.

EXPLANATION OF PROVISIONS: CALCULATION OF ALLOWABLE DEDUCTION

The final regulations require deduction of the amount of the allowable deduction for a qualified charitable contribution by an amount equal to one-half of the amount of gain (other than gain subject to certain ordinary income recapture provisions) which would not have been long-term capital gain if the property had been sold by the taxpayer at fair market value at the date of contribution. A second reduction is made if the amount of the allowable deduction which remains after the first reduction is more than twice the basis of the contributed property.

The final regulations also provide rules for determining the basis of contributed property which is inventory. The basis of such contributed property must be determined under the donor's method of accounting for inventory for purposes of United States income tax. The donor must decrease cost of goods sold for the year of contribution by the amount of this basis.

In addition the regulations do not allow a deduction for amounts which would have been subject to certain ordinary income recapture provisions if the property had been sold.

COMMENTS AND CHANGES IN THE REGULATIONS

The proposed regulations provided, in §1.170A-4A(b)(2), that a use inconsistent with the requirements of section 170(e)(3) or the regulations under that section would result in a reduction of the donor's charitable contribution deduction. The final regulations modify this rule to provide that the donor's deduction is not reduced if the donor establishes that, at the time of contribution, the donor reasonably anticipated that the donated property would be used in a manner consistent with the requirements. This modification was made in response to comments and to make the regulations under section 170(e)(3) conform more closely to the requirements of other regulations under section 170.

The proposed regulations provided, in §1.170A-4A(b)(2)(ii)(E), that the term "infant" meant a child under six years of age. The final regulations provide that the term "infant" means a minor child, as determined by the laws of the jurisdiction in which the child resides. Although it was believed that the term "infant" described a very young (younger than school-age) child, several comments pointed out that the term "infant" can also reasonably refer to a "minor". The change was made, therefore, as responsive to comments and as consistent with the intent of section 170(e)(3).

The proposed regulations provided, in §1.170A-4A(b)(3), that an organization may not receive property or money in exchange for the transfer of the contributed property. Numerous comments presented the common situation where an organization (such as a food bank) charges a nominal fee to another organization in connection with the transfer of contributed property to that organization. The fee is not in exchange for the property, and is not based on the value of the property but is charged to cover administrative, warehousing, and other similar costs. The language of section 170(e)(3) would appear to permit the collection of such a fee. Thus, the final regulations provide, subject to certain requirements, that a contribution may qualify under this section if a fee is charged to cover administrative, warehousing, or other similar costs. The fee may only be charged by one organization to another organization. No fee, for administration costs or otherwise, may be charged in connection with a transfer of contributed property directly from an organization to ill or needy individuals or infants.

The proposed regulations provided, in §1.170A-4A(b)(4), that adequate books and records must be kept to show the identity of the donor and transferring organization, the use of the property, and the nature of any disposition of the property. Several comments stated that this requirement necessitated burdensome recordkeeping. Since these recordkeeping requirements should not be unnecessarily burdensome, the rule in the final regulations has been modified to reduce required recordkeeping. The final rules make it clear that the books and records need not reflect a tracing of the receipt and disposition of specific terms of donated property. It is sufficient if the books and records disclose compliance with the requirements of section 170(e)(3) by reference to aggregate quantities of donated property. The books and records are adequate if they reflect the total amount of property received and distributed (or used), and outline the procedure used for determining that the ultimate recipient of the property is an ill or needy individual, or infant. However, the books and records need not reflect the names of the ultimate individual recipients or the property distributed to (or used by) each one.

DRAFTING INFORMATION

The principal author of this regulation is Eileen Murphy of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Amendments to the Regulations

The amendments to 26 CFR Part 1 are as follows:

Paragraph 1. Section 1.170A-1 is amended by revising the seventh sentence of paragraph (a)(1) and by revising paragraph (c)(1). These revised provisions read as follows:

§1.170A-1 Charitable, etc., contributions and gifts; allowance of deduction.

(a) *In general*—(1) *Allowance of deduction.* *** For special rules relating to computation of the amount of the deduction with respect to a charitable contribution of certain ordinary income or capital gain property, see section 170(e) and §§1.170A-4 and 1.170A-4A.***

* * * * *

(c) *Value of a contribution in property.*

(1) If a charitable contribution is made in property other than money, the amount of the contribution is the fair market value of the property at the time of the contribution reduced as provided in section 170(e)(1) and paragraph (a) of §1.170A-4, or section 170(e)(3) and paragraph (c) of §1.170A-4A.

Par. 2. Section 1.170A-4 is amended by deleting from paragraph (b)(4) the phrase "or 1252(a)" and inserting in lieu thereof "1252(a), or 1254(a)".

Par. 3. There is added immediately after §1.170A-4 the following new section:

§1.170A-4A Special rule for the deduction of certain charitable contributions of inventory and other property.

(a) *Introduction.* Section 170(e)(3) provides a special rule for the deduction of certain qualified contributions of inventory and certain other property. To be treated as a "qualified contribution", a contribution must meet the restrictions and requirements of section 170(e)(3)(A) and paragraph (b) of this section. Paragraph (b)(1) of this section describes the corporations whose contributions may be subject to this section, the exempt organizations to which these contributions may be made, and the kinds of property which may be contributed. Under paragraph (b)(2) of this section, the use of the property must be related to the purpose or function constituting the ground for the exemption of the organization to which the contribution is made. Also, the property must be used for the care of the ill, needy, or infants. Under paragraph (b)(3) of this section, the recipient organization may not, except as there provided, require or receive in exchange money, property, or services for the transfer or use of property contributed under section 170(e)(3). Under paragraph (b)(4) of this section, the recipient organization must provide the contributing taxpayer with a written statement representing that the organization intends to comply with the restrictions set forth in paragraph (b)(2) and (3) of this section on the use and transfer of the property. Under paragraph (b)(5) of this section, the contributed property must conform to any applicable provisions of the Federal Food, Drug, and Cosmetic Act (as amended), and the regulations thereunder, at the date of contribution and for the immediately preceding 180 days. Paragraph

(c) of this section provides the rules for determining the amount of reduction of the charitable contribution under section 170(e)(3). In general, the amount of the reduction is equal to one-half of the amount of gain (other than gain described in paragraph (d) of this section) which would not have been long-term capital gain if the property had been sold by the donor-taxpayer at fair market value at the date of contribution. If, after this reduction, the amount of the deduction would be more than twice the basis of the contributed property, the amount of the deduction is accordingly further reduced under paragraph (c)(1) of this section. The basis of contributed property which is inventory is determined under paragraph (c)(2) of this section, and the donor's cost of goods sold for the year of contribution must be adjusted under paragraph (c)(3) of this section. Under paragraph (d) of this section, a deduction is not allowed for any amount which, if the property had been sold by the donor-taxpayer, would have been gain to which the recapture provisions of section 617, 1245, 1250, 1251, or 1252 would have applied. For purposes of section 170(e)(3) the rules of §1.170A-4 apply where not inconsistent with the rules of this section.

(b) *Qualified contributions*—(1) *In general.* A contribution of property qualifies under section 170(e)(3) of this section only if it is a charitable contribution—

(i) By a corporation, other than a corporation which is an electing small business corporation within the meaning of section 1371(b):

(ii) To an organization described in section 501(c)(3) and exempt under section 501(a), other than a private foundation, as defined in section 509(a), which is not an operating foundation, as defined in section 4942(j)(e);

(iii) Of property described in section 1221(1) or (2);

(iv) Which contribution meets the restrictions and requirements of paragraph (b)(2) through (5) of this section.

(2) *Restrictions on use of contributed property.* In order for the contribution to qualify under this section, the contributed property is subject to the following restrictions in use. If the transferred property is used or transferred by the donee organization (or by any subsequent transferee that furnished to the donee organization the written statement described in paragraph (b)(4)(ii) of this section) in a manner inconsistent with the requirements of subdivision (i) or (ii) of this paragraph (b)(2) or the requirements of paragraph (b)(3) of this section, the donor's deduction is reduced to the amount allowable under section 170 of the regulations thereunder, determined without regard to section 170(e)(3) of this section. If, however, the donor establishes that, at the time of the contribution, the donor reasonably anticipated that the property would be used in a manner consistent with those requirements, then the donor's deduction is not reduced.

(i) *Requirement of use for exempt purpose.* The use of the property must be related to the purpose or function constituting the ground for exemption under section 501(c)(3) of the organization to which the contribution is made. The property may not be used in connection with any activity which gives rise to unrelated trade or business income, as defined in sections 512 and 513 and the regulations thereunder.

(ii) *Requirement of use for care of the ill, needy, or infants*—(A) *In general.* The property must be used for the care of the ill, needy, or infants, as defined in this subdivision (ii). The property itself must ultimately either be transferred to (or for the use of) the ill, needy, or infants for their care or be retained for their care. No other person may use the contributed property except as incidental to primary use in the care of the ill, needy, or infants. The organization may satisfy the requirement of this subdivision by transferring the property to a relative, custodian, parent or guardian of the ill or needy individual or infant, or to any other individual if it makes a reasonable effort to ascertain that the property will ultimately be used primarily for the care of the ill or needy individual, or infant, and not for the primary benefit of any other person. The recipient organization may transfer the property to another exempt organization within the jurisdiction of the United States which meets the description contained in paragraph (b)(1)(ii) of this section, or to an organization not within the jurisdiction of the United States that, but for the fact that it is not within the jurisdiction of the United States, would be described in paragraph (b)(1)(ii) of this section. If an organization transfers the property to another organization, the transferring organization must obtain a written statement from the transferee organization as set forth in paragraph (b)(4) of this section. If the property is ultimately transferred to, or used for the benefit of, ill or needy persons, or infants, not within the jurisdiction of the United States, the organization which so transfers the property outside the jurisdiction of the United States must necessarily be a corporation. See section 170(c)(2) and §1.170A-11(a). For purposes of this subdivision, if the donee-organization charges for its transfer of contributed property (other than a fee allowed by paragraph (b)(3)(ii) of this section), the requirement of this subdivision is not met. See paragraph (b)(3) of this section.

(B) *Definition of the ill.* An ill person is a person who requires medical care within the meaning of §1.213-1(e). Examples of ill persons include a person suffering from physical injury, a person with a significant impairment of a bodily organ, a person with an existing handicap, whether from birth or later injury, a person suffering from malnutrition, a person with a disease, sickness, or infection which significantly impairs physical health, a person partially or totally incapable of self-care (including incapacity due to old age). A person suffering from mental illness is included if the person is hospitalized or institutionalized for the mental disorder, or, although the person is nonhospitalized or noninstitutionalized, if the person's mental illness constitutes a significant health impairment.

(C) *Definition of care of the ill.* Care of the ill means alleviation or cure of an existing illness and includes care of the physical, mental, or emotional needs of the ill.

(D) *Definition of the needy.* A needy person is a person who lacks the necessities of life, involving physical, mental, or emotional well-being, as a result of poverty or temporary distress. Examples of needy persons include a person who is financially impoverished as a result of low income and lack of financial resources, a person who temporarily lacks food or shelter (and the means to provide for it), a person who is the victim of a natural disaster (such as fire or flood), a person who is the victim of a civil disaster (such as a civil disturbance), a person who is temporarily not self-sufficient as a result of a sudden and severe personal or family crisis (such as a person who is the victim of a crime of violence or who has been physically abused), a person who is a refugee or immigrant and who is experiencing language, cultural, or financial difficulties, a minor child who is not self-sufficient and who is not cared for by a parent or guardian, and a person who is not self-sufficient as a result of previous institutionalization (such as a former prisoner or a former patient in a mental institution).

(E) *Definition of care of the needy.* Care of the needy means alleviation or satisfaction of an existing need. Since a person may be needy in some respects and not needy in other respects, care of the needy must relate to the particular need which causes the person to be needy. For example, a person whose temporary need arises from a natural disaster may need temporary shelter and food but not recreational facilities.

(F) *Definition of infant.* An infant is a minor child (as determined under the laws of the jurisdiction in which the child resides).

(G) *Definition of care of an infant.* Care of an infant means performance of parental functions and provision for the physical, mental, and emotional needs of the infant.

(3) *Restrictions on Transfer of contributed property*—(i) *In general.* Except as otherwise provided in subdivision (ii) of this paragraph (b)(3), a contribution will not qualify under this section, if the donee-organization or any transferee of the donee-organization requires or receives any money, property, or services for the transfer or use of property contributed under section 170(e)(3). For example, if an organization provides temporary shelter for a fee, and also provides free meals to ill or needy individuals, or infants using food contributed under this section the contribution of food is subject to this section (if the other requirements of this section are met). However, the fee charged by the organization for the shelter may not be increased merely because meals are served to the ill or needy individuals or infants.

(ii) *Exception.* A contribution may qualify under this section if the donee-organization charges a fee to another organization in connection with its transfer of the donated property, if—

(A) The fee is small or nominal in relation to the value of the transferred property and is not determined by this value; and

(B) The fee is designed to reimburse the donee-organization for its administrative, warehousing, or other similar costs.

For example, if a charitable organization (such as a food bank) accepts surplus food to distribute to other charities which give the food to needy persons, a small fee may be charged to cover administrative, warehousing, and other similar costs. This fee may be charged on the basis of the total number of pounds of food distributed to the transferee charity but not on the basis of the value of the food distributed. The provisions of this subdivision (ii) do not apply to a transfer of donated property directly from an organization to ill or needy individuals, or infants.

(4) *Requirement of a written statement*—(i) *Furnished to taxpayer.* In the case of any contribution made on or after March 3, 1982, the donee-organization must furnish to the taxpayer a written statement which—

(A) Describes the contributed property, stating the date of its receipt;

(B) Represents that the property will be used in compliance with section 170(e)(3) and paragraphs (b)(2) and (3) of this section;

(C) Represents that the donee-organization meets the requirements of paragraph (b)(1)(ii) of this section; and

(D) Represents that adequate books and records will be maintained, and made available to the Internal Revenue Service upon request.

The written statement must be furnished within a reasonable period after the contribution, but not later than the date (including extensions) by which the donor is required to file a United States corporate income tax return for the year in which the contribution was made. The books and records described in (D) of this subdivision (i) need not trace the receipt and disposition of specific items of donated property if they disclose compliance with the requirements by reference to aggregate quantities of donated property. The books and records are adequate if they reflect total amounts received and distributed (or used), and outline the procedure used in determining that the ultimate recipient of the property is an ill or needy individual, or infant. However, the books and records need not reflect the names of the ultimate individual recipients or the property distributed to (or used by) each one.

(ii) *Furnished to transferring organization.* If an organization that received a contribution under this section transfers the contributed property to another organization on or after March 3, 1982, the transferee organization must furnish to the transferring organization a written statement which contains the information required in paragraph (b)(4)(i)(A), (B) and (D) of this section. The statement must also represent that the transferee organization meets the requirements of paragraph (b)(1)(ii) of this section (or, in the case of a transferee organization which is a foreign organization not within the jurisdiction of the United States, that, but for such fact, the organization would meet the requirements of paragraph (b)(1)(ii) of this section). The written statement must be furnished within a reasonable period after the transfer.

(5) *Requirement of compliance with the Federal Food, Drug, and Cos-*

metic Act—(i) *In general.* With respect to property contributed under this section which is subject to the Federal Food, Drug, and Cosmetic Act (as amended), and regulations thereunder, the contributed property must comply with the applicable provisions of that Act and regulations thereunder at the date of the contribution and for the immediately preceding 180 days. In the case of specific items of contributed property not in existence for the entire period of 180 days immediately preceding the date of contribution, the requirement of this paragraph (b)(5) is considered met if the contributed property complied with that Act and the regulations thereunder during the period of its existence and at the date of contribution and if, for the 180 day period prior to contribution other property (if any) held by the taxpayer at any time during that period, which property was fungible with the contributed property, complied with that Act and the regulations thereunder during the period held by the taxpayer.

(ii) *Example.* The rule of this paragraph (b)(5) may be illustrated by the following example.

Example. Corporation X a grocery store, contributes 12 crates of navel oranges. The oranges were picked and placed in the grocery store's stock two weeks prior to the date of contribution. The contribution satisfies the requirements of this paragraph (b)(5) if X complied with the Act and regulations thereunder for 180 days prior to the date of contribution with respect to all navel oranges in stock during that period.

(c) *Amount of reduction*—(1) *In general.* Section 170(e)(3)(B) requires that the amount of the charitable contribution subject to this section which would be taken into account under section 170(a), without regard to section 170(e), must be reduced before applying the percentage limitations under section 170(b). The amount of the first reduction is equal to one-half of the amount of gain which would not have been long-term capital gain if the property had been sold by the donor-taxpayer at its fair market value on the date of its contribution, excluding, however, any amount described in paragraph (d) of this section. If the amount of the charitable contribution which remains after this reduction exceeds twice the basis of the contributed property, then the amount of the charitable contribution is reduced a second time to an amount which is equal to twice the amount of the basis of the property.

(2) *Basis of contributed property which is inventory.* For the purposes of this section, notwithstanding the rules of §1.170A-1(c)(4), the basis of contributed property which is inventory must be determined under the donor's method of accounting for inventory for purposes of United States income tax. The donor must use as the basis of the contributed item the inventoriable carrying cost assigned to any similar item not included in closing inventory. For example, under the LIFO dollar value method of accounting for inventory, where there has been an invasion of a prior year's layer, the donor may choose to treat the item contributed as having a basis of the unit's cost with reference to the layer(s) of prior year(s) cost or with reference to the current year cost.

(3) *Adjustment to cost of goods sold.* The donor of property which is inventory contributed under this section must make a corresponding adjustment to cost of goods sold by decreasing the cost of goods sold by the amount of basis determined under paragraph (c)(2) of this section.

(4) *Examples.* The rules of this paragraph (c) may be illustrated by the following examples:

Example (1). During 1978 corporation X, a calendar year taxpayer, makes a qualified contribution of women's coats which were section 1221(1) property. The fair market value of the property at the date of contribution is $1,000, and the basis of the property is $200. The amount of the charitable contribution which would be taken into account under section 170(a) is the fair market value ($1,000). The amount of gain which would not have been long-term capital gain if the property had been sold is $800 ($1,000 − $200). The amount of the contribution is reduced by one-half the amount which would not have been capital gain if the property had been sold ($800/2 = $400).

After this reduction, the amount of the contribution which may be taken into account is $600 ($1,000 − $400). A second reduction is made in the amount of the charitable contribution because this amount (as first reduced to $600) is more than $400 which is an amount equal to twice the basis of the property. The amount of the further reduction is $200 [$600 − (2 × $200)], and the amount of the contribution as finally reduced is $400 [$100 − ($400 + $200)]. X would also have to decrease its cost of goods sold for the year of contribution by $200.

Example (2). Assume the same facts as set forth in example (1) except that the basis of the property is $600. The amount of the first reduction is $200 (($1,000 − $600)/2).

As reduced, the amount of the contribution which may be taken into account is $800 ($1,000 − $200). There is no second reduction because $800 is less than $1,200 which is twice the basis of the property. However, X would have to decrease its cost of goods sold for the year of contribution by $600.

(d) *Recapture excluded.* A deduction is not allowed under section 170(e)(3) or this section for any amount which, if the property had been sold by the donor-taxpayer on the date of its contribution for an amount equal to its fair market value, would have been treated as ordinary income under section 617, 1245, 1250, 1251, or 1252. Thus, before making either reduction required by section 170(e)(3)(B) and paragraph (c) of this section, the fair market value of the contributed property must be reduced by the amount of gain that would have been recognized (if the property had been sold) as ordinary income under section 617, 1245, 1250, 1251, or 1252.

(e) *Effective date.* This section applies to qualified contributions made after October 4, 1976.

Par. 4. Section 1.170A-11 is amended by adding the word ", and" to the end of paragraph (a)(3), by deleting paragraph (a)(4), and by redesignating paragraph (a)(5) as paragraph (a)(4).

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of

1954 (68A Stat. 917, 26 U.S.C. 7805).

ROSCOE L. EGGER, JR.,
Commissioner of
Internal Revenue.

Approved January 13, 1982.

JOHN E. CHAPOTON,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on January 29, 1982, 8:45 a.m., and published in the issue of the Federal Register for February 1, 1982, 47 F.R. 4508)

Section 171.—Amortizable Bond Premium

26 CFR 1.171-2: Determination of bond premium.

Bond premium amortization; yield method. The yield method is a reasonable method of amortizing bond premium under section 171 of the Code.

Rev. Rul. 82-10

ISSUES

Is the yield method a reasonable method of amortizing bond premium under section 171 of the Internal Revenue Code?

FACTS

Taxpayer, a corporation, uses the accrual method of accounting and files its returns on a calendar-year basis. Taxpayer has acquired bonds, purchased at a premium, for investment purposes. The bonds purchased by the taxpayer are of two types: either the interest payable to the holder of the bond is fully excludable from gross income (tax-exempt bonds) or fully includable in gross income (taxable bonds). Both the tax-exempt and taxable bonds purchased by taxpayer have a maturity date or earlier call date of 10 years from the date they were issued.

Taxpayer has adjusted the bases of both the tax-exempt and taxable bonds by amortizing the premiums. Premium represents the excess of a bond's basis over the amount payable at maturity, or, in the case of callable bonds, the earlier call date. With respect to taxable bonds, taxpayer deducts the amount of premium amortized in computing taxable income.

In determining the amount of amortizable premium, taxpayer has regularly employed the yield method of amortization (also known as the scientific method) for both income tax and financial reporting purposes. Under the yield method of amortization, the annual yield rate of a particular bond is first determined as follows:

(1) $AI = I - \frac{P}{N}$ AI = Average Income
I = Interest
P = Premium
N = Number of Years to Maturity

(2) $AC = \frac{C + M}{2}$ AC = Average Cost
C = Cost of Bond
M = Maturity Value of Bond

(3) $Y = \frac{AI}{AC}$ Y = Yield (annual yield rate)

The amount of premium amortized for a prescribed period is then determined as follows:

(1) the annual stated interest rate is applied against the face amount of the bond;

(2) the annual yield rate is applied against the taxpayer's basis or adjusted basis in the bond; and

(3) the amount in (2) is subtracted from the amount in (1).

The computations and operations of the yield method of bond premium amortization are illustrated by the following example:

Taxpayer purchased for $10,800 a 10-year tax-exempt bond, with a face amount of $10,000 and a stated interest rate of 6% payable semi-annually. The annual yield rate of this bond is 5%, determined as follows:

(1) $$AI = I - \frac{P}{N} = \$600 - \frac{\$800}{10} = \$520$$

(2) $$AC = \frac{C + M}{2} = \frac{\$10{,}800 + \$10{,}000}{2} = \$10{,}400$$

(3) $$Y = \frac{AI}{AC} = \frac{\$520}{\$10{,}400} = 5\%$$

The amount of the bond premium computed under the yield method for the first two months the bond is held by taxpayer is as follows:

First month

(1) $\frac{\$10{,}000 \times 6\%}{12} =$ $50.00

(2) $\frac{\$10{,}800 \times 5\%}{12} =$ − 45.00

Amortization $ 5.00

Second Month

(1) $\frac{\$10{,}000 \times 6\%}{12} =$ $50.00

(2) $\frac{10{,}795.00\ (\$10{,}800 - \$5.00) \times 5\%}{12} =$ − 44.98

Amortization $ 5.02

LAW AND ANALYSIS

Section 171(b)(3) of the Code provides that the amount of bond premium amortizable in a tax year will be determined (A) according to the method of amortizing bond premium regularly employed by the holder of the bond, if the method is reasonable; and (B) in all other cases, according to regulations prescribing reasonable methods of amortizing bond premium prescribed by the Secretary.

Section 1.171-2(f)(1) of the regulations provides that a determination of amortizable bond premium on any bond to which section 171 applies will be made according to (i) the method of amortization regularly employed by the taxpayer, if it is reasonable; or (ii) in all other cases, the method of amortization prescribed by this section.

The method prescribed by section 1.171-2(f)(2)(i) of the regulations is the straight-line method. Under the straight-line method, the amortizable bond premium is an amount that bears the same ratio to the bond premium on the bond as the number of months in the tax year during which the bond is held by the taxpayer bears to the number of months from the beginning of the tax year (or, if the bond was acquired in the tax year, from the date of acquisition) to the date of maturity or earlier call date.

Section 171(b)(3) of the Code, in addition to referring to reasonable methods prescribed by the regulations, allows any other method of bond premium amortization to be used if it is regularly used and is reasonable. Section 1.171-2(f) of the regulations, in prescribing a bond premium amortization method in which a constant amount is amortized on a monthly basis (straight-line method), also expressly recognizes the use of another method if it is regularly used and is reasonable.

Under the yield method, (1) the amount of premium amortized rises progressively over the life of the bond, (2) the amount of the taxpayer's yield on its investment (interest payable on bond less premium amortization) decreases over the bond's life, and (3) the annual yield rate on the taxpayer's investment remains constant during the bond's life.

HOLDING

The yield method is a reasonable method of amortizing bond premium under section 171 of the Code.

Any change in the taxpayer's present method of accounting to the method described in this revenue ruling is a change in method of accounting to which the provisions of sections 446 and 481 of the Code apply.

Part VII.—Additional Itemized Deductions for Individuals

Section 212.—Expenses for Production of Income

26 CFR 1.212-1: Nontrade or nonbusiness expenses.
(Also Sections 162, 262, 6049; 1.162-1, 1.262-1; 1.6049-1.)

Nonbusiness expenses; checkwriting fees. An individual taxpayer who maintains an interest-bearing personal checking account (NOW account) may not deduct fees charged by the bank for the privilege of writing the checks as expenses for the production of income under section 212 of the Code. The taxpayer must include in gross income and the bank must report on Form 1099-INT the full amount of interest earned on the account, not reduced by the amount of the fees.

Rev. Rul. 82-59

ISSUE

May an individual taxpayer who maintains an interest-bearing personal checking account (NOW account) deduct fees charged for checks written against the account under section 212 of the Internal Revenue Code?

FACTS

A, an individual taxpayer, maintains an interest-bearing personal checking account with *BK*, a domestic bank. *A* is paid interest on amounts on deposit in the checking account as long as *A* maintains a minimum balance of $500 in the account. The checks *A* writes are personal and are not for payments in connection with any profit making activity or trade or business of *A*. *BK* charges *A* a fee for each check *A* writes against the interest-bearing checking account.

Each year *BK* reports on Form 1099-INT, Statement for Recipients of Interest Income, the interest *A* earned on the checking account during the calendar year.

LAW AND ANALYSIS

Section 162(a) of the Code allows a deduction for all the ordinary and necessary expenses paid or incurred during the tax year in carrying on any trade or business.

Section 212 of the Code provides that an individual may deduct all the ordinary and necessary expenses paid or incurred during the tax year for the production or collection of income and for the management, conservation, or maintenance of property held for the production of income.

Section 1.212-1(d) of the Income Tax Regulations provides that for expenses to be deductible under section 212 of the Code, they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of taxable income, or to the management, conservation or maintenance of property held for the production of income.

Section 1.212-1(g) of the regulations provides two conditions for deducting expenses, such as fees for services of investment counsel, custodial fees, clerical help, and office rent, under section 212 of the Code when the expenses were paid or incurred by a taxpayer in connection with investments the taxpayer holds. These conditions are (1) the expenses must be paid or incurred by the taxpayer for the production or collection of income or for the management, conservation, or maintenance of investments held by the taxpayer for the production of income, and (2) the expenses must be ordinary and necessary under all the circumstances that relate to the type of investment and to the relation of the taxpayer to the investment.

In this case the fee charged by *BK* is for the privilege of writing checks rather than for maintaining the interest-bearing checking account. In addition, the checks *A* writes are not used to make payments in connection with any profit making activity or trade or business of *A*. Thus, the fees charged by *BK* against *A*'s checking account are not related to the production or collection of taxable income or the management, conservation, or maintenance of investments held for the production of income. Compare Rev. Rul. 75-548, 1975-2 C.B. 331, which holds that taxpayers are allowed a deduction under section 212 of the Code for service fees charged by a bank in connection with the operation of an automatic investment service in which the taxpayers, with the bank acting as their agent, may elect to invest a portion of their checking accounts in the common stock of specified corporations.

HOLDING

A may not deduct the fees charged by *BK* for the checks written by *A* against the interest-bearing checking account under section 212 of the Code.

In addition, *A* must include in *A*'s gross income and *BK* must report on Form 1099-INT the full amount of interest earned by *A* on the checking account, not reduced by the amount of the fees charged by *BK*. See section 6049(a) and (b) of the Code.

---

26 CFR 1.212-1: Nontrade or nonbusiness expenses.

Whether a deduction under section 212 of the Code will be allowed to a taxpayer that pays a third party to burn down a building. See Rev. Rul. 82-74, page 110.

Section 213.—Medical, Dental, Etc., Expenses

26 CFR 1.213-1: Medical, dental, etc., expenses.

Medical expenses; hair transplants; hair removal through electrolysis; tattoos; ear piercing. Expenditures for hair transplants performed by a doctor and expenditures for removal of hair through electrolysis performed by a licensed technician are amounts paid for medical care expenses. Expenditures for tattoos and ear piercing are not amounts paid for medical care.

Rev. Rul. 82-111

ISSUE

Are expenditures made under the situations described below amounts paid for medical care as defined in section 213(e) of the Internal Revenue Code?

FACTS

Situation 1—The taxpayer pays for hair transplants performed on the taxpayer by a dermatologist or plastic surgeon.

Situation 2—The taxpayer pays for hair removal through electrolysis performed on the taxpayer by a state licensed technician.

Situation 3—The taxpayer pays for a tattoo inscribed on the taxpayer's arm by a "tattoo artist."

Situation 4—The taxpayer pays for an ear piercing procedure performed by a licensed physician.

LAW

Section 213(a) of the Code provides that there shall be allowed as a deduction the amount by which the amount of the expenses paid during the taxable year for medical care of the taxpayer exceeds three percent of the taxpayer's adjusted gross income.

Section 213(e)(1) of the Code provides that the term "medical care" means amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body.

Section 1.213-1(e)(1)(ii) of the Income Tax Regulations provides that amounts paid for operations or treatments affecting any portion of the body are deemed to be for the purpose of affecting any structure or function of the body and are therefore paid for medical care. See also Rev. Rul. 76-332, 1976-2 C.B. 81; Rev. Rul. 73-603, 1973-2 C.B. 76; and Rev. Rul. 73-201, 1973-1 C.B. 140.

ANALYSIS

Situation 1

In performing a hair transplant, a dermatologist or surgeon removes a hair and its follicle from the fringes of the scalp and transplants it into a bald area on top of the head. The operation requires the transplanting of many tiny plugs of tissue, including the skin and subcutaneous layers. In order for the procedure to succeed, the implant must "take" in much the same way as any other graft must survive in its new location. See R. Rothenber, *The Complete Surgical Code* 109 (1974).

In *Mattes v. Commissioner*, 77 T.C. 650 (1981), acq., page 1, this Bulletin, the Tax Court concluded that because the scalp is a part of the body, the transplantation of the taxpayer's hair from one portion of the scalp to another through a surgical procedure certainly affected a structure of the body. The Tax Court further held that the hair transplantation undergone by the taxpayer was a treatment for a physical defect within the meaning of "medical care" under section 1.213-1(e)(1)(ii) of the regulations.

Situation 2

Hair removal through electrolysis is a form of epilation by electric current. A fine needle with a rounded tip is attached to an electrode and inserted into the hair follicle parallel to and touching the hair approximately three to five millimeters below the surface of the skin to the base of the follicle. The electric current concentrates at the tip of the needle and is transmitted to the cells of the hair bulb, thereby permanently destroying the hair root or papilla. See E. Epstein, *Skin Surgery* 216 (2nd ed. 1962).

Because this operation penetrates the entire length of the follicle and destroys living tissue, it affects a structure of the body, the skin and subcutaneous layers.

Situation 3

Tattooing is done by pricking the skin with coloring matter. Generally a form of dye is injected into the skin to represent various figures and designs using a power driven multiple spiked tool. See G. Lewis, *Practical Dermatology* 311 (2d ed.).

Tattooing, in contrast to hair transplants and hair removal through electrolysis, is not a procedure that affects a structure or function of the body. It is merely a method of pigmenting the skin without affecting the subcutaneous layers.

Situation 4

Ear piercing is generally done by piercing the earlobe with a large needle after deadening the area to be pierced. After the ear is pierced, generally, gold or stainless steel earrings are attached until the ear heals. Earrings must be worn regularly after healing to prevent the hole from closing through natural tissue growth. Without regular wear, the hole will grow shut.

Ear piercing, because it is a superficial procedure, and because of its impermanent effect does not affect a function or structure of the body within the meaning of section 213 of the Code and the regulations thereunder.

HOLDINGS

Situation 1

Expenditures by the taxpayer for hair transplants are amounts paid for medical care as defined in section 213(e) of the Code.

Situation 2

Expenditures by the taxpayer for hair removal through electrolysis are amounts paid for medical care as defined in section 213(e) of the Code.

Situation 3

Expenditures by the taxpayer for tattooing are not amounts paid for medical care as defined in section 213(e) of the Code.

Situation 4

Expenditures by the taxpayer for ear piercing are not amounts paid for medical care as defined in section 213(e) of the Code.

Section 217.—Moving Expenses

26 CFR 1.217-2: Deduction for moving expenses paid or incurred in taxable years beginning after December 31, 1969.

T.D. 7810

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Moving Expense Deduction for Foreign Moves and for Retirees or Decedents who were Working Abroad

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to special rules for foreign moving expenses and the allowance of moving expense deductions in the case of retirees or dependents of decedents who were working abroad. Changes to the applicable tax law were made by the Foreign Earned Income Act of 1978. The regulations provide necessary guidance to the public for compliance with the law.

DATE: The regulations are effective for expenses paid or incurred in taxable years beginning after December 31, 1978, and for expenses paid or incurred in the taxable year beginning during 1978 of taxpayers who do not make an election pursuant to section 209(c) of the Foreign Earned Income Act of 1978 (Pub. Law. 95-615, [1978-2 C.B. 415, 416] 92 Stat. 3109) to have section 911 under prior law apply to that taxable year.

FOR FURTHER INFORMATION CONTACT: David R. Haglund of the Legislation and regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Ave., N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3459).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On May 22, 1980, the FEDERAL REGISTER published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 217(h) and (i) of the Internal Revenue Code of 1954. The amendments were proposed to conform the regulations to section 204 of the Foreign Earned Income Act of 1978 (92 Stat. 3106). After consideration of all comments regarding the proposed amendments, those amendments are adopted as revised by this Treasury decision.

The effectiveness of these regulations will be evaluated on the basis of comments and information received from the public, other Government agencies, and offices within the Treasury Department and Internal Revenue Service. Under the regulations, no additional reporting or filing requirements have been imposed on taxpayers.

SPECIAL RULES FOR FOREIGN MOVES

The regulations reflect the special rules for the deduction of moving expenses in the case of foreign moves. In the case of a foreign move, the new rules change the 30-day limitation on the deduction of the cost of temporary quarters to 90 days. The new rules increase the ceiling on deductibility of these temporary living costs and costs of searching for a new residence from $1,500 to $4,500 for a foreign move. The $3,000 limitation applicable for the deductibility of the aggregate qualified residence sale, purchase or lease expenses is raised to $6,000 for a foreign move. Deductible foreign moving expenses are changed to include the cost of certain storage fees.

MOVING EXPENSE DEDUCTION FOR RETIREES OR DECEDENTS WHO WERE WORKING ABROAD

The regulations reflect the new rules allowing for the deduction of qualified retiree moving expenses and qualified survivor moving expenses. Qualified retiree moving expenses are expenses that are incurred by an individual whose former principal place of work and former residence were outside the United States and that are incurred for a move to a new residence in the United States in connection with the bona fide retirement of the individual. The regulations define "bona fide retirement" generally to mean the permanent withdrawal from gainful full-time employment and self-employment. An individual who at the time of withdrawal from gainful full-time employment or self-employment, intends the withdrawal to be permanent shall be considered to be a bona fide retiree even though the individual ultimately resumes gainful full-time employment or self-employment. An individual's intention is determined relevant facts and circumstances. One comment stated that the definition of bona fide retirement is too restrictive and should be revised to delete the requirement of permanent withdrawal from employment. This suggestion was not adopted. Under the regulations, whether resumption of employment disqualifies an individual as a bona fide retiree depends on the particular facts and circumstances of each situation. This rule provides sufficient flexibility for making the determination.

Qualified survivor moving expenses are expenses that are paid or incurred by the spouse or any dependent of a decedent who had a principal place of work outside the United States. The expenses must be incurred for a move to the United States from a former residence outside the United States that was the residence of the decedent and the taxpayer. The move must begin within 6 months after the death of the decedent. The proposed regulations provide that a move begins when either the taxpayer's household goods and personal effects are packed and in transit to a residence in the United States or the taxpayer leaves for former residence to travel to a new place of residence in the United States or both. One comment noted that it may be impossible to accomplish the requisite packing and movement of household goods in a six-month period due to internal conditions of the foreign country and requested that a more flexible rule for determining when a move begins be adopted. In response to this suggestion, the regulations have been revised to provide that a move will also be considered to begin when the taxpayer contracts for the moving of his or her household goods and personal effects to a residence in the United States but only if the move is completed within a reasonable time thereafter.

DRAFTING INFORMATION

The principal author of this regulation is David R. Haglund of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 1 is amended to read as follows:

Section 1.217-2 is revised by redesignating paragraph (h) as paragraph (j) and inserting new paragraphs (h) and (i), to read as follows:

§1.217-2 Deduction for moving expenses paid or incurred in taxable years beginning after December 31, 1969.

* * * * *

(h) *Special rules for foreign moves*—(1) *Increase in limitations.* In the case of a foreign move (as defined in paragraph (h)(3) of this section), paragraph (b)(6) of this section shall be applied by substituting "90 consecutive" for "30 consecutive" each time it appears. Paragraph (b)(9)(ii), (iii) and (v) of this section shall be applied by substituting "$6,000" for "$3,000" each time it appears and by substitution "$4,500" for "$1,500" each time it appears. Paragraph (b)(9)(ii) of this section shall be applied by substituting "$5,000" for "$2,000" each time it appears and by substituting "1979" for "1977" and "1980" for "1978" each time they appear in the last sentence. Paragraph (b)(9)(v) of this section shall be applied by substituting "$2,250" for "$750" each time it appears. Paragraph (b)(9)(vi) of this section does not apply.

(2) *Allowance of certain storage fees.* In the case of a foreign move, for purposes of this section, the moving expenses described in pararaph (b)(3) of this section shall include the reasonable expenses of moving household goods and personal effects to and from storage, and of storing such goods and effects for part or all of the period during which the new place of work continues to be the taxpayer's principal place of work.

(3) *Foreign move.* For purposes of this paragraph, the term "foreign move" means a move in connection with the commencement of work by the taxpayer at a new principal place of work located outside the United States. Thus, a move from the United States to a foreign country or from one foreign country to another foreign country qualifies as a foreign move. A move within a foreign country also qualifies as a foreign move. A move from a foreign country to the United States does not qualify as a foreign move.

(4) *United States.* For purposes of this paragraph, the term "United States" includes the possessions of the United States.

(5) *Effective date.* The provisions of this paragraph apply to expenses paid or incurred in taxable years beginning after December 31, 1978. The paragraph also applies to the expenses paid or incurred in the taxable year beginning during 1978 of taxpayers who do not make an election pursuant to section 209(c) of the Foreign Earned Income Act of 1978 (Pub. Law 95-615, [1978-2 C.B. 415, 416] 92 Stat. 3109) to have section 911 under prior law apply to that taxable year.

(i) *Allowance of deductions in case of retirees or decedents who were working abroad*— (1) *In general.* In the case of any qualified retiree moving expenses or qualified survivor moving expenses, this section (other than paragraph (h)) shall be applied to such expenses as if they were incurred in connection with the commencement of work by the taxpayer as an employee at a new principal place of work located within the United States and the limitations of paragraph (c)(4) of this section (relating to the minimum period of employment) shall not apply.

(2) *Qualified retiree moving expenses.* For purposes of this paragraph, the term "qualified retiree moving expenses" means any moving expenses which are incurred by an individual whose former principal place of work and former residence were outside the United States and which are incurred for a move to a new residence in the United States in connection with the bona fide retirement of the individual. "Bona fide retirement" means the permanent withdrawal from gainful full-time employment and self-employment. An individual who at the time of withdrawal from gainful full-time employment or self-employment, intends the withdrawal to be permanent shall be considered to be a "bona fide retiree" even though the individual ultimately resumes gainful full-time employment or self-employment. An individual's in-

tention may be evidenced by relevant facts and circumstances which include the age and health of the individual, the customary retirement age of employees engaged in similar work, whether the individual is receiving a retirement allowance under a pension annuity, retirement or similar fund or system, and the length of time before resuming full-time employment or self-employment.

(3) *Qualified survivor moving expenses.* (i) For purposes of this paragraph, the term "qualified survivor moving expenses" means any moving expenses—

(A) Which are paid or incurred by the spouse or any dependent (as defined in section 152) of any decedent who (as of the time of his death) had a principal place of work outside the United States, and

(B) Which are incurred for a move which begins within 6 months after the death of the decedent and which is to a residence in the United States from a former residence outside the United States which (as of the time of the decedent's death) was the residence of such decedent and the individual paying or incurring the expense.

(ii) For purposes of subdivision (i)(B), a move begins when—

(A) The taxpayer contracts for the moving of his or her household goods and personal effects to a residence in the United States but only if the move is completed within a reasonable time thereafter:

(B) The taxpayer's household goods and personal effects are packed and in transit to a residence in the United States; or

(C) The taxpayer leaves the former residence to travel to a new place of residence in the United States.

(4) *United States.* For purposes of this paragraph, the term "United States" includes the possessions of the United States.

(5) *Effective date.* The provisions of this paragraph apply to expenses paid or incurred in taxable years beginning after December 31, 1978. The paragraph also applies to the expenses paid or incurred in the taxable year beginning during 1978 of taxpayers who do not make an election pursuant to section 209(c) of the Foreign Earned Income Act of 1978 (Pub. Law 95-615, 92 Stat. 3109) to have section 911 under prior law apply to that taxable year.

(j) *Effective date.* ***

(This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).)

ROSCOE L. EGGER, JR.,
Commissioner of
Internal Revenue.

Approved February 4, 1982.

JOHN E. CHAPOTON,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on February 5, 1982, 4:07 p.m., and published in the issue of the Federal Register for February 10, 1982, 47 F.R. 6002)

Part VIII.—Special Deductions for Corporations

Section 243.—Dividends Received By Corporations

26 CFR 1.243-1: Deduction for dividends received by corporations.
(Also Section 61; 1.61-9.)

Corporate shareholder; dividends received deduction; stock purchased after record date for dividend payment. A corporation that receives dividends on stock of a domestic corporation purchased after the record date for the dividend payment is not entitled to the dividends received deduction under section 243 of the Code.

Rev. Rul. 82-11

ISSUE

Is a corporation that receives dividends on stock of a domestic corporation purchased after the record date for the dividend payment entitled to the dividends received deduction under section 243 of the Internal Revenue Code?

FACTS

X is a domestic corporation whose stock is traded on a major stock exchange (Exchange). During May 1980, *X* declared a dividend of 3*x* dollars on its preferred stock, including dividends in arrears. On the declaration date, *X* stock was trading on the exchange for 10*x* dollars per share.

X set a record date of June 15, 1980, and a payment date of June 21, 1980, for determining the shareholders entitled to the dividend. The exchange set an "ex-dividend" date of June 21, 1980. When a stock is trading ex-dividend, the seller is entitled to a dividend that has already been declared but not yet paid.

In most cases, the exchange designates stock as ex-dividend 4 business days before the record date. The practical effect of the 4 business day delay between the ex-dividend date and the record date is that the owner of stock on the ex-dividend date and the shareholder of record on the record date is the same party, because it generally takes corporations 4 business days after a sale of stock to substitute the purchaser for the seller as the new shareholder. However, in the present situation, the exchange set an ex-dividend date that was after the record date. Under exchange rules, this may be done in special situations, such as this one, where the stock in question has had a large dividend declared. The rules of the exchange provide that when the ex-dividend date occurs after the record date and the stock is sold between the record date and ex-dividend date, the seller must sign an agreement that the buyer is entitled to the dividend. The ex-dividend price was 7*x* dollars per share.

Y and *Z* are domestic corporations unrelated to *X* or to each other. On June 18, 1980, *Y* sold 100*x* shares of *X* stock to *Z*, through the exchange, at 10*x* dollars per share, the current trading price. *Y* had purchased these shares in 1978 for 5*x* dollars per share. At the time of the sale *Y* signed an agreement stating that *Z* was entitled to the "dividend". *Z* collected the 300*x* dollars after the payment by *X* on June 21, and sold the *X* shares 6 months later for 7*x* dollars per share.

On its federal income tax return for 1980, *Y* reported a long term capital gain of 500*x* dollars on its sale of *X* shares to *Z*. *Z* reported dividend income of 300*x* dollars and deducted 85 percent of this amount as a dividends received deduction. *Z* carried its capital loss on its subsequent sale of the *X* stock back to 1977.

LAW AND ANALYSIS

Section 243 of the Code provides that a corporation is entitled to a dividends received deduction of 85 percent for certain dividends received from domestic corporations, subject to the limitations of section 246, which are not relevant here.

Section 1.61-9(c) of the Income Tax Regulations provides that when stock is sold after a dividend is declared and after the date on which the seller becomes entitled to the dividend, the dividend is ordinarily income to the seller.

In *Estate of Henry W. Putnam v. Commissioner*, 324 U.S. 393 (1945), Ct. D. 1638, 1945 C.B. 345, the Supreme Court of the United States held that a shareholder does not become entitled to a dividend for federal income tax purposes before the record date because the proper distributee cannot be determined with certainty until the record date. In reaching this conclusion, the Court stated that federal rather than state law controlled the determination of when a shareholder is entitled to receive a dividend.

Rev. Rul. 74-562, 1974-2 C.B. 28, holds that a gift to a charity of stock and declared dividends after the record date but before the date of payment does not prevent the inclusion of the dividends in gross income of the donor under section 61 of the Code. The conclusion of Rev. Rul. 74-562 follows from the decision in *Helvering v. Horst*, 311 U.S. 112 (1940), Ct. D. 1472, 1940-2 C.B. 206, in which the United States Supreme Court held that a father could not prevent inclusion in income of interest on bonds he owned by giving the interest coupons to his son before their due date.

Therefore, in the present situation, the ex-dividend rules of a stock exchange will not control the determination of when a shareholder becomes entitled to a dividend for federal income tax purposes. *Y* cannot shift the burden of income taxation on dividends by selling the underlying shares of stock to *Z* after the dividends have been declared and determined owing to *Y* as the record holder of the shares on the record date because it is the holder on the record date who is entitled to a declared dividend.

The operation of the exchange rules does not alter the federal income tax consequences of the transaction. As of the record date, *Y* becomes contractually entitled to receive the dividend from *X*. The actions of the exchange in setting the ex-dividend date subsequent to the record date cannot change *Y*'s contractual entitlement to that dividend as of the record date. *Y*'s right to receive the dividend for federal income tax purposes becomes fixed as of that date. Accordingly, the amount paid by *Z* to *Y* represents payment for two separate items, specifically, the right to receive the dividend and consideration for the underlying shares of stock. *See Commissioner v. P. G. Lake, Inc.*, 356 U.S. 260 (1958), Ct. D. 1823, 1958-1 C.B. 516, which characterized as a substitute for ordinary income an amount received in exchange for assignment of a working interest in oil leases, and *Hort v. Commissioner*, 313 U.S. 28 (1941), Ct. D. 1502, 1941-1 C.B. 319, characterizing a payment received in cancellation of a lease as a substitute for rental income. Therefore, only 700*x* dollars of the amount received by *Y* is treated as received in exchange for the *X* stock. The remaining 300*x* dollars received by *Y* is treated as dividend income and, therefore, *Y* is entitled to a dividends received deduction under section 243 of the Code with respect to this amount. The 300*x* dollars received by *Z* from *X* was not received as dividends within the meaning of section 243, and *Z* may not claim a dividends received deduction under that section, because *Z*'s receipt of the 300*x* dollars is attributable, for federal income tax purposes, to its agreement with *Y*, rather than its position as a shareholder in *X*. *Z* realizes no income on the receipt of the 300*x* dollars because this amount represents a return of *Z*'s 300*x* dollar payment to *Y* for the right to receive the dividend. *Z*'s basis in the *X* stock upon its subsequent transfer will be determined with reference to a purchase price of 700*x* dollars, the portion of *Z*'s payment attributable to the underlying shares, thus eliminating *Z*'s capital loss on its subsequent sale of the *X* stock.

HOLDING

A corporation that receives dividends on stock of a domestic corporation purchased after the record date for the dividend payment is not entitled to the dividends received deduction under section 243 of the Code.

Part IX.—Items Not Deductible

Section 262.—Personal, Living, and Family Expenses

26 CFR 1.262-1: Personal, living, and family expenses.

Whether a member of the United States foreign service may deduct substantiated "home leave" expenses as business traveling expenses. See Rev. Rul. 82-2, page 27.

---

26 CFR 1.262-1: Personal, living, and family expenses.

Whether an individual taxpayer may deduct service fees charged by a bank against an interest-bearing checking account under section 212 of the Code. See Rev. Rul. 82-59, page 47.

Section 263. Capital Expenditures

26 CFR 1.263(a)-1: Capital expenditures; in general.

Amounts designated as "interest" paid by a limited partnership for timber cutting rights are part of the purchase price of the timber. See Rev. Rul. 82-78, page 30.

---

26 CFR 1.263(a)-2: Examples of capital expenditures.
(Also Sections 162, 167; 1.162-4, 1.167(a)-1.)

Capital expenditures; replacement of telephone wires. The cost of replacing telephone wires with buried cable is to be capitalized under section 263(a) of the Code, and depreciated over the useful life of the cable under section 167(a).

Rev. Rul. 82-12

ISSUE

Is the cost of replacing telephone wires with buried cable to be currently expensed as a repair under section 162(a) of the Internal Revenue Code or, alternatively, capitalized under section 263(a) and depreciated over the useful life of the cable under section 167(a)?

FACTS

In 1979, the taxpayer, a telephone company that is a regulated public utility, began replacing overhead drop lines with buried cable. A drop line is the line that connects the utility pole with the customer's house protector unit, the unit to which the customer's telephone is connected. The new cable has an estimated useful life in excess of one year.

The taxpayer initially capitalized the amounts expended and a depreciation expense was deducted on its federal income tax return for tax year 1979. Subsequently, the State Commerce Commission notified the taxpayer that its accounting for the buried cable as a capital expenditure was incorrect. It based this determination on Federal Communications Commission (FCC) rules and regulations, which require the replacement cost to be expensed and classified under the account "repairs to station equipment."

LAW AND ANALYSIS

Section 162(a) of the Code provides that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 1.162-4 of the Income Tax Regulations provides that repairs in the nature of replacements, to the extent that they arrest deterioration and appreciably prolong the life of the property, shall either be capitalized and depreciated, in accordance with section 167 of the Code, or be charged against the depreciation reserve if such an account is kept.

Section 263(a) of the Code provides that as a general rule no deduction shall be allowed for any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate.

Section 1.263(a)-2 of the regulations sets forth examples of capital expenditures including the cost of acquisition, construction or erection of buildings, machinery and equipment, furniture and fixtures, and similar property having a useful life substantially beyond the taxable year.

In *Old Colony Railroad Co. v. Commissioner*, 284 U.S. 552 (1932), XI-1 C.B. 274 at 277 (1932), the government argued that the taxpayer should be required to follow the method of accounting in accordance with the ruling of its regulatory agency, the Interstate Commerce Commission. The Supreme Court rejected this position stating that the rules of accounting enforced upon a carrier by a regulatory agency are not binding upon the Commissioner, nor may the Commissioner resort to the rules of that body, made for other purposes, for the determination of tax liability under the Revenue Act. See Rev. Rul. 70-118, 1970-1 C.B. 34, in which bond discount charged against income in the year of issuance pursuant to Interstate Commerce Commission accounting rules was required for federal income tax purposes to be amortized over the life of the bonds.

Thus, the accounting rules of a regulatory agency are not controlling for federal income tax purposes.

In Rev. Rul. 73-203, 1973-1 C.B. 146, the taxpayer, a regulated public utility, was ordered by an appropriate governmental body to relocate its existing overhead electric source wires when they interfered with construction of an expressway. The expenditures incurred by the taxpayer for installation of new sections of overhead and underground electric transmission lines to take the place of the lines retired were capital expenditures for new sections that had a useful life of more than one year.

The installation of the underground cable is in the nature of a replacement or a permanent improvement.

HOLDING

The cost of replacing telephone wire with buried cable must be capitalized and depreciated over the useful life of the cable.

See section 168 of the Code for the treatment of the cost of replacing telephone wire with buried cable that is placed in service after December 31, 1980.

---

26 CFR 1.263(c)-1: Intangible drilling and development costs in the case of oil and gas wells.

Whether the costs incurred in drilling carbon dioxide (CO_2) source wells are subject to the option to expense as intangible drilling and development cost (IDC). See Rev. Rul. 82-17, page 95.

Section 274.—Disallowance of Certain Entertainment, Etc., Expenses

26 CFR 5e.274-8: Travel expenses of Members of Congress.

T.D. 7802

TITLE 26—INTERNAL REVENUE—CHAPTER I, SUBCHAPTER A PART 5e—TRAVEL EXPENSES OF MEMBERS OF CONGRESS

Travel Expenses of Members of Congress

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary Regulations.

SUMMARY: This document contains temporary regulations relating to deductions for Members of Congress for travel expenses in Washington, D.C. allowed without substantiation. Changes to the applicable law were made by the Black Lung Benefits Amendments of 1981 [Pub. L. 97-119, page 307, this Bulletin]. The regulations would provide Members of Congress with guidance as to the amount they may deduct without substantiation for amounts relating to travel away from home in Washington, D.C.

DATES: The regulations are effective for taxable years beginning after December 31, 1980.

FOR FURTHER INFORMATION CONTACT: Jason R. Felton of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution

Avenue, N.W., Washington, D.C. 20224 Attention: CC:LR:T, (202)566-3318, not a toll-free call.

SUPPLEMENTARY INFORMATION

BACKGROUND

Section 162 allows a taxpayer a deduction for all ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business including traveling expenses while away from home. For this purpose, the residence of a Member of Congress within the District or State which he represents is to be considered his home. Therefore, most Members will be entitled to deduct all their living expenses including meals and lodging while discharging their Congressional duties in Washington, D.C. Under section 274, traveling expenses while away from home must be substantiated.

Until recently, a Member's deduction for these expenses was limited to $3,000. Section 139(a) of Pub. L. 97-51 [page 306, this Bulletin] as amended by section 133(a) of Pub. L. 97-92 [page 306, this Bulletin] eliminated this $3,000 limitation for taxable years beginning after December 31, 1980. Section 113(b) of the Black Lung Benefits Revenue Act of 1981 [page 307, this Bulletin] amended subsection (f) of section 280A to require the Secretary or his delegate to prescribe amounts that would be deductible by Members of Congress in Washington, D.C. as travel expenses without substantiation.

The regulations provide that Members of Congress may deduct a designated amount for each Congressional day in the year. The designated amount is determined by reference to the maximum amount of reimbursement available to a government employee traveling in Washington, D.C. Congressional days are determined by reducing the number of days in the year by periods in which Congress is not in session for 5 or more consecutive days. The number of Congressional days may be different for the House of Representatives and the Senate.

A Member of Congress may elect to deduct the amounts prescribed by this section without substantiating such amounts. In such a case, no other deductions will be allowed for meals, lodging, or other incidental travel expenses. However, travel expenses incurred away from the Washington, D.C. area will continue to be deductible in addition to the amounts prescribed by the new regulation.

DRAFTING INFORMATION

The principal author of these temporary regulations is Jason R. Felton of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, on matters of both substance and style.

Adoption of amendments to the regulations

Accordingly, a new Part 5e Temporary Income Tax Regulations Travel Expenses of Members of Congress is added to Title 26 of the Code of Federal Regulations. Part 5e reads as follows:

PART 5e—TEMPORARY INCOME TAX REGULATIONS, TRAVEL EXPENSES OF MEMBERS OF CONGRESS

SEC. 5e.274-8 Travel Expenses of Members of Congress

Authority: Secs. 280A(f)(4)(B) and 7805 Internal Revenue Code of 1954 (95 Stat. 1641, 26 U.S.C. 280A(f)(4)(B); 68A Stat. 917, 26 U.S.C. 7805).

§5e.274-8 Travel Expenses of Members of Congress.

(a) *In general.* Members of Congress (including any Delegate and Resident Commissioner) who are away from home within the meaning of section 162(a), in the Washington, D.C. area, may elect in accordance with paragraph (f) to deduct an amount described in paragraph (c) as living expenses, without substantiation. A Member who elects under this section may not deduct any amount for the living expenses described in paragraph (b). A Member who does not make an election under this section must substantiate his expenses for living in Washington, D.C. in accordance with section 274 and §1.274-5.

(b) *Living expenses covered.* The amount allowed to be deducted without substantiation, pursuant to this section, for costs incurred for living in the Washington, D.C. area represents amounts expended for meals, lodging, and other incidental expenses. Meals include the actual cost of the food and expenses incident to the preparation and serving thereof. Lodging includes amounts paid for rent, care of premises, utilities, insurance and depreciation of household furnishings owned by the Member. In the case of a Member who lives in a residence owned by him in the Washington, D.C. area, the cost of lodging also includes depreciation on such residence. Other incidental expenses include laundry, cleaning, and local transportation. Local transportation includes travel within a 50 mile radius of Washington, D.C., whether by private automobile, taxi cab or other transportation for hire. Interest and taxes on personal property will not be considered expenses to be included within this paragraph.

(c)(1) *Amounts allowed without substantiation.* The amount that may be deducted pursuant to section 162 and these regulations is an amount equal to the product of the number of Congressional days in the taxable year, multiplied by the designated amount. The designated amount is—

(i) In the case of a Member who deducts interest and taxes attributable to the ownership of a personal residence in the Washington, D.C. area, two-thirds of the maximum amount of actual subsistence for Washington, D.C. payable pursuant to 5 U.S.C. 5702(c), or

(ii) In the case of a Member not described in paragraph (c)(1)(i), the maximum amount of actual subsistence for Washington, D.C. payable pursuant to 5 U.S.C. 5702(c).

A Member who incurs interest and taxes on his residence in the Washington, D.C. area may forego the deduction of such amounts and use the designated amount prescribed by paragraph (c)(1)(ii).

(2) If a Member, who lives in a residence owned by him in the Washington, D.C. area, chooses to deduct amounts prescribed in paragraph (c)(1), the Member must treat as an adjustment to the basis of such residence an amount equal to 20 percent of the maximum amount of actual subsistence multiplied by the number of Congressional days. Such adjustments will be considered a proper adjustment for exhaustion, wear, and tear under this subtitle.

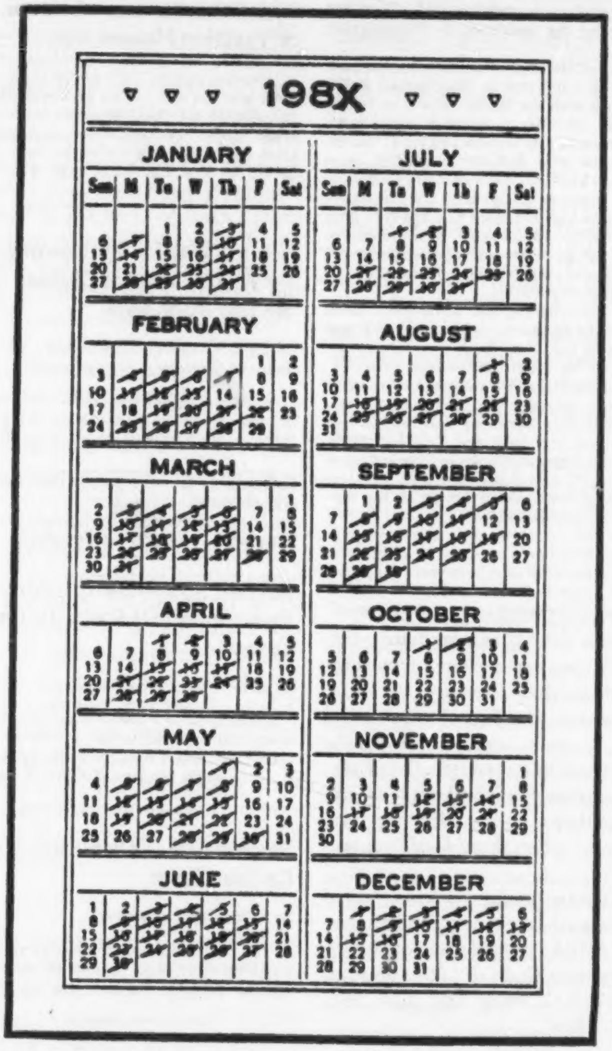
(d) *Congressional days.* The number of Congressional days with respect to a Member is the number of days in the taxable year less the number of days in periods in which the Member's Congressional chamber was not in session for 5 consecutive days or more (including Saturday and Sunday). The number of days with respect to a Member is determined without regard to whether or not the Member was in the Washington, D.C. area on such days.

(e) *Other deductible amounts.* This section does not preclude the deduction of otherwise allowable expenses for travel fares (other than local travel in the Washington, D.C.), long distance telephone and telegraph, and travel expenses incurred other than in the Washington, D.C. area. However, such expenses are subject to the substantiation requirements of section 274.

(f) *Election.* To elect to deduct the amounts prescribed by this section, a Member must attach to his return for the taxable year a statement indicating, (1) that the deduction for travel expenses while living in the Washington, D.C. area are computed pursuant to §5e.274-8, and (2) whether a separate deduction is being taken for interest and taxes paid or incurred with respect to the personal residence of the Member if in the Washington, D.C. area.

(g) *Effective date.* This section is effective for taxable year beginning after December 31, 1980.

(h) *Examples.* The following examples are based on a calendar from a Final Edition of the Calendar of the United States, House of Representatives and History of Legislation. The marked days indicate days the House of Representatives was in session.



▿ ▿ ▿ 198X ▿ ▿ ▿

JANUARY

Sun	M	Tu	W	Th	F	Sat
		1	2	~~3~~	4	5
6	~~7~~	8	9	~~10~~	11	12
13	~~14~~	15	16	~~17~~	18	19
20	21	~~22~~	~~23~~	~~24~~	25	26
27	~~28~~	~~29~~	~~30~~	~~31~~		

FEBRUARY

Sun	M	Tu	W	Th	F	Sat
					1	2
3	~~4~~	~~5~~	~~6~~	~~7~~	8	9
10	~~11~~	~~12~~	~~13~~	14	15	16
17	18	~~19~~	~~20~~	~~21~~	~~22~~	23
24	~~25~~	~~26~~	~~27~~	~~28~~	29	

MARCH

Sun	M	Tu	W	Th	F	Sat
						1
2	~~3~~	~~4~~	~~5~~	~~6~~	7	8
9	~~10~~	~~11~~	~~12~~	~~13~~	14	15
16	~~17~~	~~18~~	~~19~~	~~20~~	21	22
23	~~24~~	~~25~~	~~26~~	~~27~~	~~28~~	29
30	~~31~~					

APRIL

Sun	M	Tu	W	Th	F	Sat
		~~1~~	~~2~~	3	4	5
6	7	8	9	10	11	12
13	14	~~15~~	~~16~~	~~17~~	18	19
20	~~21~~	~~22~~	~~23~~	~~24~~	25	26
27	~~28~~	~~29~~	~~30~~			

MAY

Sun	M	Tu	W	Th	F	Sat
				~~1~~	2	3
4	~~5~~	~~6~~	~~7~~	~~8~~	9	10
11	~~12~~	~~13~~	~~14~~	~~15~~	16	17
18	~~19~~	~~20~~	~~21~~	~~22~~	23	24
25	26	27	~~28~~	~~29~~	~~30~~	31

JUNE

Sun	M	Tu	W	Th	F	Sat
1	2	~~3~~	~~4~~	~~5~~	6	7
8	~~9~~	~~10~~	~~11~~	~~12~~	~~13~~	14
15	~~16~~	~~17~~	~~18~~	~~19~~	~~20~~	21
22	~~23~~	~~24~~	~~25~~	~~26~~	~~27~~	28
29	~~30~~					

JULY

Sun	M	Tu	W	Th	F	Sat
		~~1~~	~~2~~	3	4	5
6	7	8	9	10	11	12
13	14	15	16	17	18	19
20	~~21~~	~~22~~	~~23~~	~~24~~	~~25~~	26
27	~~28~~	~~29~~	~~30~~	~~31~~		

AUGUST

Sun	M	Tu	W	Th	F	Sat
					~~1~~	2
3	4	5	6	7	8	9
10	11	12	13	14	15	16
17	~~18~~	~~19~~	~~20~~	~~21~~	~~22~~	23
24	~~25~~	~~26~~	~~27~~	~~28~~	29	30
31						

SEPTEMBER

Sun	M	Tu	W	Th	F	Sat
	1	2	~~3~~	~~4~~	~~5~~	6
7	~~8~~	~~9~~	~~10~~	~~11~~	12	13
14	~~15~~	~~16~~	~~17~~	~~18~~	~~19~~	20
21	~~22~~	~~23~~	~~24~~	~~25~~	26	27
28	~~29~~	~~30~~				

OCTOBER

Sun	M	Tu	W	Th	F	Sat
			~~1~~	~~2~~	3	4
5	6	7	8	9	10	11
12	13	14	15	16	17	18
19	20	21	22	23	24	25
26	27	28	29	30	31	

NOVEMBER

Sun	M	Tu	W	Th	F	Sat
						1
2	3	4	5	6	7	8
9	10	11	~~12~~	~~13~~	~~14~~	15
16	~~17~~	~~18~~	~~19~~	~~20~~	~~21~~	22
23	24	25	26	27	28	29
30						

DECEMBER

Sun	M	Tu	W	Th	F	Sat
	~~1~~	~~2~~	~~3~~	~~4~~	~~5~~	6
7	8	~~9~~	~~10~~	~~11~~	~~12~~	~~13~~
14	~~15~~	~~16~~	17	18	19	20
21	22	23	24	25	26	27
28	29	30	31			

Example (1). In determining the number of Congressional days for 198X for which the designated amount may be computed, the number of days in such year is reduced by 125 days determined as follows:

5 days	February	14-18
12 days	April	3-14
5 days	May	23-27
18 days	July	3-20
16 days	August	2-17
5 days	August	29-September 2
40 days	October	3-November 11
9 days	November	22-November 30
15 days	December	17 December 31
125		

Thus for 198X (a leap year) a typical Member of the House of Representatives will have 241 (366-125) Congressional days.

Example (2). On August 1, Z, a calendar year taxpayer is elected to the Congress to fill the unexpired term of Member Y. In determining the number of Congressional days, Z may only consider the number of days during the year for which he was a Member of Congress. For Z the number of Congressional days is 68.

Example (3). Member X, a calendar year taxpayer, owns his own home in Washington, D.C., where he lives with his family. While in Washington, D.C. Member X is away from home within the meaning of section 162(a). X maintains no records attributable to his expenses in Washington, D.C. X has been a Member of Congress for the entire year. The maximum amount of subsistance for Washington, D.C. for 198X is $75. X may deduct for 198X $18,075 (241 days X $75) attributable to expenses while away from home in Washington, D.C. Even if X maintained records as to living expenses in Washington, D.C., X may choose to deduct $18,075 as the total amount attributable to living expenses in Washington, D.C., X may choose to deduct $18,075 as the total amount attributable to living expenses in Washington, D.C. If X deducts $18,075 X may not deduct any interest and taxes under section 163 or 164 attributable to the residence in Washington, D.C.

Example (4). Member C, a calendar year taxpayer owns his own home in Washington, D.C., where he lives with his family. While in Washington, D.C. Member C is away from home within the meaning of section 162(a). C can establish that he paid $12,000 as interest on a mortgage and $3,000 in local real estate taxes. C has been a Member of Congress for the entire year. C may choose to deduct $12,050 (241 days X [2/3 X $75]) attributable to expenses in Washington, D.C. Further, C may deduct under sections 163 and 164 $12,000 of interest and $3,000 of taxes respectively.

Example (5). Assume the same facts as in Example (4). In addition, on March 15, 16, and 17, Member C travels to New York City to deliver a speech for which he receives an honorarium which he includes in income. C receives no additional amounts for travel reimbursement. While in New York City C incurs $350 for 3 nights lodging at a hotel and $150 for meals. In addition to the amounts deductible pursuant to this section, C may deduct the $500 as travel expenses. Such deduction is subject to the substantiation rules of section 274.

Example (6). Assume the same facts as example (5). Member C receives, in addition to the honorarium, $600 reimbursement for travel expenses. C must include the $600 in income and may deduct the travel expenses he incurred.

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impractical to issue it with notice and public procedure under subsection (b) of section 553 of title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in sections 280A(f)(4)(B) and 7805 of the Internal Revenue Code of 1954 (95 Stat. 1641; 26 U.S.C. 7805, 68A Stat. 917; 26 U.S.C. 7805).

ROSCOE L. EGGER, JR.,
Commissioner of
Internal Revenue

Approved January 13, 1982.

JOHN E. CHAPOTON,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on January 15, 1982, 10:48 a.m., and published in the issue of the Federal Register for January 21, 1982, 47 F.R. 2986)

Section 280A.—Disallowance of Certain Expenses in Connection with Business Use of Home, Rental of Vacation Homes, etc.

Whether section 1034 of the Code applies to defer gain on the portion of a residence used as an office in the home where no deduction is allowed under section 280A concerning certain expenses in connection with the business use of a home. See Rev. Rul. 82-26, page 114.

Section 280C.—Portion of Wages for Which Credit is Claimed Under Section 40 or 44B

26 CFR 1.280C-1: Disallowance of certain deductions for wage or salary expenses.

Whether the value of meals and lodging must be used to reduce an employer's income tax deduction. See Rev. Rul. 82-43, page 10.

Subchapter C.—Corporate Distributions and Adjustments
Part I.—Distribution by Corporations
Subpart A.—Effects on Recipients

Section 303.—Distributions In Redemption Of Stock To Pay Death Taxes

26 CFR 1.303-2: Requirements.

Illustration of a distribution in redemption of stock that qualifies under section 303, notwithstanding the fact that the stock redeemed is section 306 stock. See Rev. Rul. 82-72, page 57.

Section 306.—Dispositions Of Certain Stock

26 CFR 1.306-1: General.

The proper charge to earnings and profits for a redemption, under section 303 of the Code, of section 306 stock. See Rev. Rul. 82-72, page 57.

Section 306.—Disposition of Certain Stock

26 CFR 1.306-3: Section 306 stock defined.

Reorganization; section 306 stock; exchange of preferred stock substantially the same. Preferred stock received in a reorganization defined in sections 368(a)(1)(A) and 368(a)(2)(D) of the Code is not "section 306 stock" if it is received for stock substantially the same that was not "section 306 stock" in the hands of the exchanging shareholder.

Rev. Rul. 82-118

ISSUE

Is the *S-1* preferred stock receive
the transaction described below "
tion 306 stock" within the meaning
section 306(c)(1)(B) of the Inter
Revenue Code?

FACTS

P and *S-1*, a wholly owned subs
ary of *P*, are operating companies.
is a newly formed corporation that
organized as a wholly owned subs
ary of *S-1* for purposes of the tran
tion. *P* has one class of common st
outstanding. *P* also has one class
nonvoting preferred stock outsta
ing, all of which is owned by *A*, an
dividual shareholder of *P* who
owns a significant amount of the
standing common stock of *P*. Th
preferred stock is not "section
stock" in the hands of *A*.

S-1's capital structure is identica
that of *P* with respect to its classe
common stock and preferred stock
their respective terms. In a transac
that qualified under section 36
(1)(A) and 368(a)(2)(D) of the Cod
merged into *S-2* and the sharehol
of *P* exchanged all their shares
common and preferred stock
identical shares of *S-1* common
preferred stock on a share-for-sh
basis with *A* receiving all the *S-1*
ferred stock.

LAW AND ANALYSIS

Section 306(c)(1)(B) of the C
provides that the term "section
stock" means stock which is not c
mon stock and which was recei
pursuant to a tax-free reorganizat
but only to the extent that either
effect of the transaction was
stantially the same as the receipt
stock dividend, or the stock was
ceived in exchange for section
stock.

In determining whether the effe
the issuance of preferred stock in a
organization is substantially the s
as the receipt of a stock dividend,
"cash in lieu of" test set forth in sec
1.306-3(d) of the Income Tax Reg
tions is generally applied. Sec
1.306-3(d) states that *ordinarily*

tion 306 stock includes stock which is not common stock received in pursuance of a plan of reorganization if cash received in lieu of such stock would have been treated as a dividend under section 356(a)(2) or would have been treated as a distribution to which section 301 applies by virtue of section 356(b) or section 302(d). However, several exceptions have been made to the application of this "cash in lieu of" test.

In example (2) of section 1.306-3(d) of the regulations two shareholders each own one-half of the outstanding shares of preferred stock and one-half of the outstanding shares of the common stock of a corporation. Pursuant to a reorganization within the meaning of section 368(a)(1)(E) of the Code, all the preferred stock of each shareholder was exchanged for preferred stock of a new issue which was not substantially different from the preferred stock previously held. Example (2) states that unless the preferred stock exchanged was itself section 306 stock, the preferred stock received is not section 306 stock. This conclusion is reached because the receipt of such stock was not substantially the same as the receipt of a stock dividend within the meaning of section 306(c)(1)(B), since the stock was merely a substitution for the preferred stock for which it was exchanged and such stock did not represent earnings and profit that had been previously distributed in the form of stock rather than in cash or other property.

In Rev. Rul. 79-287, 1979-2 C.B. 130, a corporation (*X*) reincorporated in another state by the creation of a new corporate shell (*Y*) into which it merged pursuant to section 368 (a)(1)(F) of the Code. Those exchanging shareholders who owned both common and preferred stock of *X* received common and preferred stock of *Y* identical in terms with the *X* stock exchanged therefor. Based upon the principles set forth in example (2) of section 1.306-3(d) of the regulations, the revenue ruling holds that since the *X* preferred stock was not originally "section 306 stock" the *Y* preferred stock received in exchange therefor is not "section 306 stock".

The reason that an exception was made in applying the "cash in lieu of" test set forth in section 1.306-3(d) of the regulations was that in each of the above situations the new preferred stock received was *substantially the same* as the old preferred stock exchanged therefore and the old preferred stock did not represent earnings and profits that had been previously distributed in the form of stock rather than in cash or other property. In effect, there was a mere substitution of the new preferred stock for the old preferred stock which left the shareholders in almost exactly the same position after the transaction as they were in before the transaction.

The same principles apply to the instant transaction. Here, the *S-1* preferred stock is identical in its terms to the *P* preferred stock with the only difference being that after the transaction *A*'s preferred stock interest will be represented immediately by the assets of *S-1*, and then by the assets of *P*, rather than vice versa. However, this shift in the assets represented by the preferred stock is not significant enough to establish that the *S-1* and *P* preferred stocks are not substantially the same since the total assets represented by the *S-1* preferred stock is no different than the total assets represented by the *P* preferred stock prior to the transaction.

HOLDING

The *S-1* preferred stock received by *A* in the reorganization under sections 368(a)(1)(A) and 368(a)(2)(D) of the Code is not "section 306 stock" within the meaning of section 306(c)(1)(B).

Subpart B.—Effects on Corporation

Section 312.—Effect on Earnings and Profits

26 CFR 1.312-1: Adjustment to earnings and profits reflecting distributions by corporations. (Also Sections 303, 306; 1.303-2, 1.306-1.)

Redemption of preferred stock that is section 306 stock; computation of earnings and profits. The charge to earnings and profits computed under section 312(a) of the Code on the redemption under section 303 of section 306 stock is subject to the limitation of section 312(e). Therefore, a portion of the redemption price must be allocated to the capital account. Rev. Rul. 74-266 modified.

Rev. Rul. 82-72

ISSUES

(1) When a corporation redeems preferred stock that is section 306 stock and section 303 of the Internal Revenue Code applies to the redemption, does the corporation charge the entire redemption price to earnings and profits under section 312(a) or must it charge part of the redemption price to its capital account under section 312(e)?

(2) If section 312(e) applies, what is the proper charge to earnings and profits for a redemption of section 306 stock?

FACTS

X was capitalized upon its incorporation, after March 1, 1913, solely with no-par value common stock. In 1978 *X* issued two shares of newly authorized $100 par value non-voting cumulative preferred stock as a nontaxable stock dividend, under section 305 of the Code, on each share of outstanding common stock. The preferred stock issued was section 306 stock as defined in section 306(c).

Some of the preferred shares (section 306 stock) were redeemed in 1981 from the estate of a deceased shareholder in a transaction qualifying under section 303 of the Code for capital gain treatment.

The preferred stock has preference over the common as to dividends. Once the preference has been met, the preferred stock does not participate with the common stock on further distributions.

LAW AND ANALYSIS

Section 306(a)(2) of the Code provides that distributions in redemption of section 306 stock shall be treated as distributions of property under section 301.

Section 303(a) of the Code provides that distributions in redemption of stock held by the estate of a decedent shall be treated as a distribution in full payment in exchange for the stock so redeemed, to the extent that the amount of the distribution does not exceed death taxes owed by the estate and the amount of certain funeral and administrative expenses.

Section 1.303-2(d) of the Income Tax Regulations provides that a distribution in redemption of stock can qualify under section 303, even if the stock redeemed is section 306 stock.

Section 316(a) of the Code provides that, except as otherwise provided in subtitle A, every distribution made by a corporation is made out of earnings and profits to the extent thereof.

Section 312(a) of the Code provides that, on the distribution of property by a corporation with respect to its stock, the earnings and profits of the corporation are decreased by the sum of (1) the amount of money, (2) the principal amount of the obligations of the corporation, and (3) the adjusted basis of other property so distributed. However, as an exception to the general rule of sections 316(a) and 312(a), section 312(e) provides that the part of the distribution in a redemption to which section 303 applies that is properly chargeable to capital account is not treated as a distribution of earnings and profits.

Even though the distribution would have been treated by the shareholder as a distribution of property under section 306(a)(2) of the Code but for the provisions of section 303 that permit the treatment of the redemption distribution by the shareholders as an exchange, section 312(e) is applicable. Section 303 changes the income tax treatment of the redemption from a distribution of property (section 306(a)(2)) to an exchange (section 303), not only at the shareholder level but also at the corporate level.

Section 1.303-2(d) of the regulations states that a redemption of section 306 stock can qualify for treatment under section 303, and section 312(e) contains no exception for its application to a section 303 redemption involving section 306 stock. Furthermore, the requirement of section 312(e) that the redeeming corporation charge part of the redemption distribution to its capital account parallels the exchange treatment of the distribution under section 303 that results in the redeemed shareholder treating the redemption distribution as a return of capital to the extent of the shareholder's adjusted basis in the redeemed stock.

Therefore, pursuant to section 312(e) of the Code, the reduction of *X*'s earnings and profits because of the redemption distribution does not include the amount of the distribution that is properly chargeable to capital account.

Neither the Code nor the regulations define the term "capital account" nor do they indicate how to determine the amount "properly chargeable" thereto. However, Rev. Rul 79-376, 1979-2 C.B. 133, consistent with several court decisions that disagreed with a previously published position of the Internal Revenue Service (Rev. Rul. 70-531, 1970-2 C.B. 76), construes the term "capital account" as representing only the amount paid in to the corporation for the common stock redeemed. Rev. Rul. 79-376 holds that the correct method for determining the proper charge to the capital account of a corporation, incorporated after March 1, 1913, under section 312(e) of the Code is the method in which the ratio between the charge to capital and the capital before retirement is the same as the ratio between the number of shares retired and the number of shares outstanding before retirement. The resulting charge to the corporation's earnings and profits is the balance of the redemption distribution. These principles are equally applicable to redemptions of preferred stock.

In the present case, the *X* preferred stock was distributed as a stock dividend and, therefore, was not issued for paid-in capital. Under these circumstances it is appropriate to allocate part of *X*'s capital account attributable to its common stock to the preferred stock. The correct method for doing this is to allocate *X*'s capital account attributable to its common stock on the date the preferred stock was issued between the common stock and preferred stock in proportion to the fair market value of each on the date of distribution. Compare section 307 of the Code and the regulations thereunder, which provide a similar allocation rule for determining a shareholder's basis of a nontaxable stock dividend under section 305; that is, part of the basis of the stock on which the stock dividend was issued is allocated to the dividend stock in proportion to the fair market values of the stocks on the date of distribution.

HOLDINGS

(1) The charge to earnings and profits computed under section 312(a) of the Code on the redemption of section 306 stock is subject to the limitation of section 312(e). Therefore, a portion of the redemption price must be allocated to *X*'s capital account.

(2) *X*'s capital account should be proportionately allocated between its common stock and preferred stock, and the amount of the redemption payment that exceeds the capital attributable to the preferred stock should be charged to earnings and profits.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 74-266, 1974-1 C.B. 73, holds that on a redemption at a premium of nonparticipating preferred stock issued for cash at par only the amount of the distribution corresponding to the dividend arrearages is chargeable to earnings and profits. The amount of the distribution in excess of those dividends plus the expenses of redemption are properly chargeable to capital account.

Rev. Rul. 74-266 is modified to hold that the amount paid into the corporation (par value) is chargeable to capital account and the dividend arrearages, redemption premium, and redemption expenses are chargeable to earnings and profits.

Rev. Rul. 74-266 is modified.

Part III.—Corporate Organizations and Reorganizations
Subpart B.—Effects on Shareholders and Security Holders

Section 355.—Distributions of Stock and Securities of a Controlled Corporation

26 CFR 1.355-1: Distribution of stock and securities of controlled corporation.

Whether recapture of investment tax credit is required due to the early disposition of "section 38 property" in a divisive reorganization qualifying under sections 355(a) and 368(a)(1)(D) when, as part of the reorganization, the "section 38 property" is transferred between affiliated corporations filing a consolidated return. See Rev. Rul. 82-20, page 6.

Subpart C.—Effects on Corporations

Section 361.—Nonrecognition of Gain or Loss to Corporations

26 CFR 1.361-1: Nonrecognition of gain or loss to corporations.

Transfer of assets and liabilities in consolidation of qualified pension plans as a result of a section 368(a) reorganization. See Rev. Rul. 82-60, page 63.

Subpart D.—Special Rules; Definitions

Section 367.—Foreign Corporations

26 CFR 7.367(c)-2: Contribution of capital to controlled corporations.
(Also Section 1491; 1.1491-1.)

Foreign corporation; contribution to capital of wholly owned subsidiary. The tax imposed by section 1491 of the Code does not apply if a domestic corporation makes a contribution to the capital of its wholly owned foreign subsidiary consisting of stock of the foreign subsidiary because such a transfer is described in section 367(b)(1). Rev. Rul. 70-291 amplified.

Rev. Rul. 82-112

ISSUE

What are the federal income tax consequences to *P*, a domestic corporation, when it contributes *FS* stock to the capital of *FS*, its wholly owned foreign subsidiary?

FACTS

FS, a foreign corporation, has outstanding only shares of common stock. *P*, a domestic corporation, owns all of the outstanding stock of *FS*. For a valid business reason, *P* contributes 25 percent of the outstanding *FS* stock to the capital of *FS*. This stock is then cancelled. Before the last day for filing its federal income tax return for the year in which this transaction occurred, *P* filed the notice required under section 7.367(b)-1(c) of the Income Tax Regulations.

LAW AND ANALYSIS

Rev. Rul. 70-291, 1970-1 C.B. 168, holds that if shareholders contribute stock in the corporation to the capital of their corporation no gain or loss is recognized to the contributing shareholders. They add the cost or other basis of the surrendered stock to their basis in the retained stock, as provided in section 1016 of the Internal Revenue Code.

Section 1491 of the Code imposes an excise tax when a domestic corporation contributes property to the capital of a foreign corporation. Section 1492(3) states that this excise tax will not apply if the transfer of property is described in section 367.

Section 367(a) of the Code generally applies to transfers of property by a United States person to a foreign corporation which are described in section 351. However, it does not apply to an exchange involving the transfer of stock of a foreign corporation that is a party to the exchange. Such an exchange is instead governed by section 367(b)(1).

Section 367(c)(2) of the Code states that a transfer of property to a foreign corporation as a contribution to capital by a transferor who owns, within the meaning of section 318, stock possessing at least 80 percent of the total combined voting power of all the stock of the foreign transferee corporation will be treated as an exchange of property for stock of the foreign transferee corporation.

Consequently, pursuant to section 367(c)(2) of the Code, the contribution to the capital of *FS* by its sole shareholder, *P*, of shares of *FS* stock is treated as an exchange. Because the exchange involves a transfer of property to a controlled corporation, it is an exchange described in section 351. Moreover, it is also an exchange described in section 367(b)(1).

Section 367(b)(2) of the Code provides that for exchanges described in section 367(b)(1) the Income Tax Regulations will provide the circumstances under which gain will be recognized and the extent to which adjustments will be made in the basis of stock. However, no provision of the temporary regulations under section 367 deals with the tax treatment of a section 351 transfer of stock in a foreign corporation by a domestic transferor.

HOLDING

Because the exchange is described in section 367(b)(1), the excise tax imposed by section 1491 will not apply. In addition, because the temporary regulations under section 367(b) do not explicitly provide the tax treatment for a 351 transfer of stock in a foreign corporation by a domestic transferor, the principles of Rev. Rul. 70-291 will be applied. Therefore, no gain or loss will be recognized to *P* when it contributes shares of *FS* stock to *FS*'s capital, and *P* will add the cost or other basis of the surrendered *FS* stock to its basis in the retained shares of *FS* stock.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 70-291 is amplified.

Section 368.—Definitions Relating to Corporate Reorganizations

26 CFR 1.368-1: Purpose and scope of exception of reorganization exchanges.

Reorganization; continuity of business. Continuity of business enterprise is not a requirement for a recapitalization to qualify as a reorganization under section 368(a)(1)(E) of the Code.

Rev. Rul. 82-34

ISSUE

Advice has been requested regarding whether continuity of business enterprise is a requirement for a recapitalization to qualify as a reorganization under section 368(a)(1)(E) of the Internal Revenue Code.

LAW, ANALYSIS AND HOLDING

Section 368(a)(1)(E) of the Code provides that a "recapitalization" is a reorganization. A recapitalization has been defined as a "reshuffling of a capital structure within the framework of an existing corporation." *Helvering v. Southwest Consolidated Corp.*, 315 U.S. 194 (1942), Ct.D. 1544, 1942-1 C.B. 218.

When a shareholder receives stock in a reorganization described in section 368(a)(1) and either before or after the transaction, the principal business assets of the transferor are sold or disposed of, a question arises whether the continuity of business enterprise requirement for a reorganization is satisfied. See sections 1.1002-1(c), 1.368-1(b) and 1.368-1(d) of the Income Tax Regulations.

The purpose of the reorganization provisions is to except from the general rule of recognizing gain or loss certain specifically described exchanges incident to corporate readjustments which effect only a readjustment of continuing interests in property under modified corporate forms. Section 1.368-1(b) of the regulations states that a continuity of the business enterprise under the modified corporate form is required in a reorganization.

Specifically, section 1.368-1(d) of the regulations provides, in general, that the transferee in a corporate reorganization must either (i) continue the transferor's historic business or (ii) use a significant portion of the transferor's historic business assets in a business.

The "continuity of business enterprise" requirement is closely related to the "continuity of shareholder interest" requirement in section 1.368-1(b) of the regulations in that both are concerned with determining whether a transaction involves an otherwise taxable transfer of stock or assets of one corporation to another corporation, as distinguished from a tax-free reorganization, which assumes only a readjustment of continuing interests under modified corporate form. The consideration of whether a transaction involves an otherwise taxable transfer of stock or assets of one corporation to another corporation is not present in a recapitalization because a recapitalization involves only a single corporation. Therefore, Rev. Rul. 77-415, 1977-2 C.B. 311, consistent with several court decisions, concludes that continuity of shareholder interest is not a requirement for a recapitalization to qualify as a reorganization under section 368(a)(1)(E) of the Code. Similarly, continuity of business enterprise is not a requirement for a recapitalization to qualify as a reorganization under section 368(a)(1)(E).

---

26 CFR 1.368-1: Purpose and scope of exception of reorganization exchanges.

Whether recapture of investment tax credit is required due to the early disposition of "section 38 property" in a divisive reorganization qualifying under sections 355(a) and 368(a)(1)(D) when, as part of the reorganization, the "section 38 property" is transferred between affiliated corporations filing a consolidated return. See Rev. Rul. 82-20, page 6.

---

26 CFR 1.368-1: Purpose and scope of exception of reorganization exchanges.

Whether the "continuity of business enterprise" requirement of section 1.368-1(d)(4) of the regulations is satisfied for a reorganization otherwise qualifying under sections 368(a)(1)(G) and 368(a)(3)(D)(ii) of the Code. See Rev. Proc. 82-23, page 474.

Part VI.—Treatment of Certain Corporate Interests as Stock for Indebtedness

Section 385.—Treatment of Certain Interests in Corporations as Stock or Indebtedness

26 CFR 1.385-1: Stock or indebtedness.

T.D. 7801

TITLE 26—INTERNAL REVENUE—CHAPTER I, SUBCHAPTER A, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Treatment of certain interests in corporations as stock or indebtedness

AGENCY: Internal Revenue Service, Treasury.

ACTION: Amendment of final regulations.

SUMMARY: This document amends final regulations relating to the treatment of certain interests in corporations as stock or indebtedness by generally changing the effective date of the regulations from January 1, 1982, to July 1, 1982.

EFFECTIVE DATE: December 31, 1981.

FOR FURTHER INFORMATION CONTACT: Carolyn Swift of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC 20224 (Attention: CC:LR:T, 202-566-3458, not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

Section 385 of the Internal Revenue Code relates to the treatment of certain interests in corporations as stock or indebtedness. Final regulations under section 385 were published in the Federal Register for Wednesday, December 31, 1980 (45 FR 86438) as T.D. 7747 [1981-1 C.B. 141]. These regulations generally would have applied to certain interests in corporations created after April 30, 1981. However, at the invitation of the Treasury and Internal Revenue Service, several public comments on the final regulations were received after December 31, 1980. The comments recommended changes in several areas of these regulations. In order for the Treasury and Internal Revenue Service to have sufficient time to examine these comments and determine whether changes should be made, the regulations were amended to apply to certain interests in corporations only if they were created after December 31, 1981. (T.D. 7774, published in the Federal Register for May 1, 1981, (46 F.R. 24945) [1981-1 C.B. 168]). After further examination of the comments and re-evaluation of the regulations, a decision was made to revise provisions of the regulations under section 385. In order to allow Treasury and the Internal Revenue Service additional time to prepare and publish revisions to certain provisions of the regulations, the regulations are amended so that, in general, they will apply to certain interests in corporations only if they are created after June 30, 1982. It is expected that the revisions to the regulations will be published in the near future as proposed changes with opportunity for public comment.

DRAFTING INFORMATION

The principal author of this regulation is Carolyn Swift of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

WAIVER OF CERTAIN PROCEDURAL REQUIREMENTS OF FINAL TREASURY DIRECTIVE

A determination has been made by Roscoe L. Egger, Jr., Commissioner of Internal Revenue, that there is need for an immediate amendment to the regulations under section 385 of the Code in order to postpone the January 1, 1982, effective date of the regulations. Because of the immediate need for this regulation, compliance with the procedural requirements of paragraphs 8 through 14 of the final Treasury directive (43 FR 52121), relating to improving regulations, would be impractical, and therefore, these requirements have not been followed.

Adoption of amendments to the regulations.

Accordingly, 26 CFR Part 1 is amended as follows:

Paragraph (a)(1) of §1.385-1 is revised to read as follows:

§1.385-1 Stock or indebtedness.

(a) *Effective date*—(1) *In general.* The regulations under section 385 apply to instruments (as defined in §1.385-3(c)) and preferred stock issued after June 30, 1982, and to loans described in §1.385-7 and guaranteed loans made after June 30, 1982.

* * * * *

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impractical to issue it with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in section 385 and 7805 of the Internal Revenue Code of 1954 (83 Stat. 613 and 68A Stat. 917; 26 U.S.C. 385 and 7805).

ROSCOE L. EGGER, JR.,
Commissioner of
Internal Revenue.

Approved December 30, 1981.

DAVID G. GLICKMAN,
Acting Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on December 30, 1981, 3:04 p.m., and published in the issue of the Federal Register for January 5, 1982, 47 F.R. 147.)

Subchapter D.—Deferred Compensation, etc.
Part I.—Pension, Profit-Sharing, Stock Bonus Plans, etc.
Subpart A.—General Rule

Section 401.—Qualified Pension, Profit-Sharing, and Stock Bonus Plans

26 CFR 1.401-1: Qualified pension, profit-sharing, and stock bonus plans.

Determination of when the holding period begins for corporate stock distributed by a profit-sharing plan to a participant. See Rev. Rul. 82-75, page 116.

---

26 CFR 1.401(b)-1: Certain retroactive changes in plan.

Extension of remedial amendment period to qualify a plan. The Service will permit a retroactive amendment to qualify a plan after the remedial amendment period has expired, including any extensions thereof, if the following two conditions are met: (1) the plan is retroactively amended to comply with the qualification requirements as of the time the defect in the plan arose, and (2) employee benefit rights are retroactively restored to the levels they would have been had the plan been in compliance with the qualification requirements from the date the defect in the plan arose.

Rev. Rul. 82-66

The purpose of this revenue ruling is to provide additional guidelines for determining when a plan may make retroactive qualifying plan amendments after the expiration of the remedial amendment period provided in section 401(b) of the Internal Revenue Code and section 1.401(b)-1 of the Income Tax Regulations.

Section 401(b) of the Code provides that a plan shall satisfy the qualification requirements of the Code for the period beginning with the date on which it was put into effect, or for the period beginning with the earlier of the date on which there was adopted or put into effect any amendment which caused the plan to fail to satisfy such requirements, and ending with the time prescribed by law for filing the return of the employer for his taxable year in which such plan or amendment was adopted (including extensions thereof) or such later time as the Secretary or his delegate may designate, if all provisions of the plan which are necessary to satisfy such requirements are in effect by the end of such period and have been made effective for all purposes for the whole of such period.

Section 1.401(b)-1(e) of the regulations provides that, at his discretion, the Commissioner may extend the remedial amendment period or may allow a particular plan to be amended after the expiration of its remedial amendment period and any applicable extension of such period.

Generally, once the remedial amendment period and any extension thereof have expired, amendment of a plan to eliminate a qualification defect will not cause the plan to be qualified for a year prior to the year in which the amendment that corrected the defect has been adopted and put into effect. However, pursuant to section 1.401(b)-1(e) of the regulations, and subject to the conditions set forth below, such a plan will be qualified for the plan year in which a request for a determination letter is made or is pending with the Internal Revenue Service and for the plan year prior to the plan year in which the plan is submitted for a determination letter if the plan is submitted by the end of the time for filing the tax return of the employer (including extensions) for the taxable year of the employer beginning with or within that prior plan year.

The Commissioner or his delegates will not permit a retroactive amendment to qualify a plan for prior years unless two conditions are met: (1) the plan is retroactively amended to comply with the qualification requirements as of the time the defect in the plan arose, and (2) employee benefit rights are retroactively restored to the levels they would have been had the plan been in compliance with the qualification requirements from the date the defect in the plan arose. Therefore, it is necessary to restore benefits to present or former employees and make any necessary amendments for plan years prior to the first year the plan is qualified by the Commissioner's exercise of discretion, even if that loss or defect in the plan does not adversely affect participants in the plan in the years for which the plan is to be qualified.

Exercise of the authority contained in section 1.401(b)-1(e) of the regulations is illustrated by the following examples:

Example I

On December 10, 1976, an employer adopted a profit-sharing plan with an effective date of January 1, 1976. A request for a determination letter was not made. The employer's taxable year and plan year are the calendar year. The plan as adopted had a disqualifying provision. On March 2, 1981, the employer adopted a remedial amendment retroactive to January 1, 1976, and submitted a request for a determination letter. The amendment placed its employees and former employees in the same position they would have been in if the plan had been qualified on its effective date. The Service will issue a determination letter to the effect that the plan qualifies as of January 1, 1980.

Example II

The facts are the same as in Example I except that the request for a determination letter was made on July 1, 1981, after the due date (including any extensions) for filing the employer's 1980 federal income tax return. The determination letter will conclude that the plan qualifies as of January 1, 1981.

Section 402.—Taxability of Beneficiary of Employees' Trust

26 CFR 1.402(a)-1: Taxability of beneficiary under a trust which meets the requirements of section 401(a).

Determination of when the holding period begins for corporate stock distributed by a profit-sharing plan to a participant. See Rev. Rul. 82-75, page 116.

Section 403.—Taxation of Employee Annuities

26 CFR 1.403(a)-1: Taxability of beneficiary under a qualified annuity plan.

Whether the life insurance company or the policyholder is the owner for federal income tax purposes of the mutual fund shares under the circumstances described in the revenue ruling. See Rev. Rul. 82-54, page 11.

---

26 CFR 1.403(a)-1: Taxability of beneficiary under a qualified annuity plan.

Clarification of certain provisions of Rev. Rul. 81-225, relating to the circumstances in which the policyholders of certain annuity contracts ("wraparound annuities") would be treated for federal income tax purposes as the owners of the mutual fund shares held by the insurance company in connection with those annuities. See Rev. Rul. 82-55, page 12.

---

26 CFR 1.403(b)-1: Taxability of beneficiary under annuity purchased by a section 501(c)(3) organization or public school.
(Also Section 7805; 301.7805-1.)

Annuities; educational organization; arrangement administered by credit union. Amounts contributed by an educational organization on behalf of its employees to a credit union that maintains separate nonforfeitable special share accounts for each employee does not constitute the purchase of an annuity contract for purposes of section 403(b) of the Code and are not excludable from the gross income of the employee. Rev. Ruls. 67-361 and 67-387 revoked.

Rev. Rul. 82-102

Advice has been requested whether, under the circumstances described below, employer contributions under an arrangement administered by a credit union constitute the purchase of an annuity contract under section 403(b) of the Internal Revenue Code.

An educational organization described in section 170(b)(1)(A) of the Code entered into a salary reduction agreement with its employees under which the employee's monthly compensation was reduced by an amount which does not exceed the exclusion allowance provided by section 403(b) of the Code. The respective amounts thus obtained are contributed on behalf of each employee to a credit union described in section 501(c)(14) of the Code that maintains separate nonforfeitable special share accounts for each employee. The funds are invested in loans to members of the credit union and in other investments appropriate for credit union funds. On retirement, each employee may receive periodic partial payments or a single-sum payment.

Section 403(b)(1) of the Code provides that if an annuity contract is purchased for an employee who performs services for an educational organization described in section 170(b)(1)(A)(ii), by an employer which is a State, a political subdivision thereof, or an agency or instrumentality, then amounts contributed by such employer for such annuity contract on or after such rights become nonforfeitable shall be excluded from the gross income of the employee for the taxable year to the extent the aggregate of such amounts does not exceed the exclusion allowance for the taxable year. Section 403(b)(7) provides, in general, that amounts paid by such an employer to a custodial account which satisfies the requirements of section 401(f)(2) shall be treated as amounts contributed for an annuity contract for an employee if the amounts are paid to provide a retirement benefit for the employee and are to be invested in regulated investment company stock to be held in that custodial account.

Section 403(b)(7) was added to the Code by the Employee Retirement Income Security Act (ERISA), Pub. L. 93-406, 1974-3 C.B. 1, to permit contributions to custodial accounts for regulated investment company stock to be treated as contributions for annuity contracts. The House report on ERISA explains this addition, as follows:

> "Under present law, contributions to a section 403(b) plan (a plan funded by employers for the benefit of teachers or employees of tax-exempt organizations) may be invested only in insurance contracts. The committee believes that it would be desirable to provide more flexibility in this area, and, accordingly, the committee bill provides that these contributions may also be placed in qualified custodial accounts if these funds are to be invested in mutual funds." (H.R. Rep. 93-807, 93rd Cong. 2d Sess. 162 [*1974*], *1974-3 Supp. C.B. 236, 397).*

The Committee Report cited above indicates Congressional intent to expand the traditional method of funding 403(b) annuity contracts by insurance companies. In section 403(b)(7) of the Code, Congress added an exception to the general rule that section 403(b) annuities must be purchased from insurance companies. However, the exception applies only when the contributions are placed in qualifying custodial accounts and invested in mutual funds. If entities other than insurance companies had been able to provide such annuities, section 403(b)(7) would not have been needed to permit such arrangements to be offered under custodial accounts. Therefore, the arrangement in this case does not meet the requirements of section 403(b)(1) because it is not funded by insurance contracts. Furthermore, it does not meet the requirements of section 403(b)(7) because the funds are not to be invested in regulated investment company stock.

Accordingly, contributions administered by the credit union in this case do not constitute the purchase of an annuity contract for purposes of section 403(b) and are not excludable from the gross income of the employee.

Rev. Rul. 67-361, 1967-2 C.B. 153, and Rev. Rul. 67-387, 1967-2 C.B. 153, which conclude that certain arrangements that are not funded by insurance contracts may be treated as annuities under section 403(b)(1) of the Code, are revoked.

However, employers may have established tax-sheltered annuities in reliance on these revenue rulings. Therefore, pursuant to the authority contained in section 7805(b) of the Code, this revenue ruling will not be applied to an arrangement established by an employer on or before May 17, 1982, if (1) the contract(s) issued pursuant to the arrangement (including self-insured arrangements) would have met the requirements of section 403(b) except that the contract(s) was not purchased from an insurance company, and (2) the arrangement only covers current and future employees of that employer. However, this section 7805(b) relief shall not apply to any employee who becomes covered for the first time under such arrangement after May 17, 1982 if the Internal Revenue Service had previously issued any written communication (either to an employer or financial institution) to the effect that the arrangement under which the contract was issued did not meet the requirements of section 403(b).

---

26 CFR 1.403(b)-1: Taxability of beneficiary under annuity purchased by a section 501(c)(3) organization or public school.

Whether the life insurance company or the policyholder is the owner for federal income tax purposes of the mutual fund shares under the circumstances described in the revenue ruling. See Rev. Rul. 82-54, page 11.

---

26 CFR 1.403(b)-1: Taxability of beneficiary under annuity purchased by a section 501(c)(3) organization or public school.

Clarification of certain provisions of Rev. Rul. 81-225, relating to the circumstances in which the policyholder of certain annuity contracts ("wraparound annuities") would be treated for federal income tax purposes as the owners of the mutual fund shares held by the insurance company in connection with those annuities. See Rev. Rul. 82-55, page 12.

Section 404.—Deduction for Contributions of an Employer to an Employees' Trust or Annuity Plan and Compensation Under a Deferred Payment Plan

26 CFR 1.404(a)-1: Contributions of an employer to an employees' trust or annuity plan and compensation under a deferred payment plan; general rule.
(Also Section 361; 1.361-1.)

Deductions; contributions; consolidation of plans; corporate reorganization. A corporate reorganization and consolidation of two qualified pension plans will not affect the deductibility of contributions by the predecessor corporation prior to the reorganization. The direct transfer of funds from the trust of the predecessor's plan to the trust of the successor's plan will not result in taxable income to the successor corporation. Rev. Rul. 58-406 superseded.

Rev. Rul. 82-60

The purpose of this Revenue Ruling is to restate Rev. Rul. 58-406, 1958-2 C.B. 153, under current law.

Rev. Rul. 58-406 concerns the deductibility of contributions made by a corporation under its qualified employees' pension plan prior to a reorganization with another corporation where the plan was combined with the qualified plan of the successor corporation. Rev. Rul. 58-406 also concerns whether the transfer of plan assets and liabilities from the trust of the predecessor corporation to that of the successor corporation will result in taxable income to the successor corporation.

Under an agreement and plan of reorganization, a corporation transferred substantially all its assets and liabilities to another corporation solely in exchange for a portion of the voting stock of the successor corporation. Thereafter, the predecessor corporation was liquidated. The exchange was a reorganization under section 368(a)(1)(C) of the Internal Revenue Code.

Both the predecessor corporation and the successor corporation had established pension plans for their employees. The two pension plans had identical provisions for coverage, vesting, and benefits accrual, and were the result of negotiations with the employees' labor unions. Both plans met the requirements of section 401(a) of the Code.

Upon the reorganization of the two corporations, the assets and liabilities of the predecessor's pension plan were transferred to the successor's pension plan. The two pension plans were then consolidated and participants under the predecessor plan became participants under the successor plan, receiving credit for service in the predecessor plan with the predecessor employer. The consolidation of the two pension plans satisfied the requirements of section 414(l) of the Code.

Contributions by an employer under a pension plan are deductible under section 404(a)(1) of the Code in the taxable year when paid or deemed paid within the limits of section 404(a), if they are paid or deemed paid within a taxable year of the employer that ends with or within a taxable year of the trust throughout which the trust is exempt under section 501(a).

The transfer of assets and liabilities from one employee benefit plan to another employee benefit plan, pursuant to a plan of corporate reorganization under section 368(a), did not violate any of the provisions of section 401(a) of the Code and the regulations thereunder and, consequently, did not affect the prior qualification of the predecessor's plan.

Accordingly, the deductibility of contributions by the predecessor corporation to its pension plan prior to such reorganization is not affected solely as a result of the reorganization. Furthermore, the direct transfer of funds from the trust of the predecessor's plan to the trust forming part of the successor's plan will not result in taxable income to the successor corporation.

The notification and filing requirements under sections 6057(b) and 6058(b) of the Code apply to consolidations of plans and are generally effective for changes in plan status occurring in plan years beginning after 1975.

Rev. Rul. 58-406 is superseded because the position set forth therein is restated under the current law in this revenue ruling.

---

26 CFR 1.404(a)-14: Special rules in connection with the Employee Retirement Income Security Act of 1974.

Deduction; contribution; full funding limitation. Guidance is provided on how the full funding limitation affects the maximum deductible contributions to a defined benefit plan. Rev. Ruls. 64-159 and 69-255 obsoleted.

Rev. Rul. 82-125

ISSUE

How does the full funding limitation affect the computation of the deductible limit under section 404(a)(1)(A)(iii) of the Internal Revenue Code under the circumstances described below?

FACTS

Employer M maintains a qualified defined benefit pension plan with a calendar plan year. The taxable year of M ends on June 30 each year, and the deductible limit for a taxable year is determined on the basis of the plan year beginning in the tax year. The funding method is an immediate gain method that directly calculates an accrued liability, the valuation rate is five percent and assets are valued at fair market value.

The results of the valuations as of January 1, 1977 and January 1, 1978 are summarized below.

	Valuation as of	
	1/1/77	*1/1/78*
(1) Accrued liability	110,000	130,000
(2) Actuarial value of the assets (market)*	139,000	146,450
(3) Actuarial (gain) loss	(14,000)	3,000
(4) Normal Cost due at the beginning of the plan year	20,000	25,000

*For purposes of section 412, whether or not previously deducted.

For the 1977 plan year, there is one combined 10-year amortization base with a limit adjustment (as defined in section 1.404(a)-14(b)(3) of the Income Tax Regulations) of $5,000 as of January 1, 1977, and a deduction carry-over of $25,000.

M contributed $10,000 on December 31, 1977 for the taxable year ending June 30, 1977. The contribution was made within the period described in section 404(a)(6) of the Code. No contribution was made for 1978.

LAW, ANALYSIS AND HOLDING

Section 404(a)(1)(A) of the Code sets forth three limitations on deductible contributions to a qualified pension plan. Section 404(a)(1)(A)(iii) limits the deductible contributions to the normal cost of the plan plus an amount necessary to amortize the past service credits over 10 years. Section 404(a)(1)(A) further limits deductible contributions to an amount equal to the full funding limitation determined under section 412.

Section 1.404(a)-14(c) of the regulations provides that the deductible limit for any taxable year is computed on the basis of a plan year. One alternative permitted is to base the deductible limit for a taxable year on the limit for the plan year beginning within that taxable year.

Section 1.404(a)-14(f) of the regulations provides that, subject to the full funding limitation, the deductible limit under section 404(a)(1)(A)(iii) is the normal cost of the plan increased (or decreased) by the limit adjustment of any unamortized 10-year amortization bases. Section 1.404(a)-14(f)(3) provides that this limit shall be computed as of the date when contributions are assumed to be made and adjusted for interest, at the valuation rate from that date (or dates) to the earlier of the last day of the plan year used to compute the deductible limit for the taxable year, or the last day of the taxable year.

For the taxable year ending June 30, 1977, the deductible limit is computed based on the 1977 calendar plan year. For that year, the deductible limit under section 404(a)(1)(A)(iii) of the Code is $25,625. This is the sum of the $20,000 normal cost and the $5,000 limit adjustment as of January 1, 1977, adjusted with interest at the 5 percent valuation rate to June 30, 1977 (the end of the taxable year).

However, section 1.404(a)-14(k) of the regulations states that the amount deductible under section 404 (a)(1)(A)(iii) for a plan year may not exceed the full funding limitation for that plan year, and that, if the total deductible contribution (including any deductible carry-over contribution) for a plan year equals or exceeds the full funding limitation for the year, all 10-year amortization bases maintained by the plan will be considered fully amortized.

Section 412(c)(7) of the Code defines the full funding limitation as of the excess of:

(A) the accrued liability (including normal cost) under the plan, over

(B) the lesser of the fair market value of the plan's assets or the actuarial value of the assets.

For purposes of section 412 this excess is computed as of the last day of the plan year. For purposes of section 404, the full funding limit is also computed as of the last day of the plan year, even when the deductible limit under section 404(a)(1)(A)(ii) or (iii) is computed as of a different date. Further, in determining the value of the plan assets, section 1.404(a)-(14)(d) of the regulations states that the amount of any plan contribution for a plan year that has not been previously deducted must be excluded from plan assets in computing the unfunded liability of a plan for the purpose of section 404 of the Code.

Applying these rules, the full funding limitation, determined as of the end of the plan year, is $15,550. This is the excess of:

(A) $136,500, the sum of the $110,000 accrued liability plus the $20,000 normal cost (both computed as of January 1, 1977), adjusted with interest at the 5 percent valuation rate to December 31, 1977, over

(B) $120,950, the $139,000 assets as of January 1, 1977 adjusted with interest at the 5 percent valuation rate to December 31, 1977, minus the $25,000 deduction carrying-over at the beginning of the plan year.

For the taxable year ending June 30, 1977, the total contribution made was $35,000 ($10,000 actual contribution plus $25,000 carry-over contribution). However, only $15,550 of the $35,000 contribution is deductible. The remaining $19,450 becomes deductible in future years in accordance with section 404(a)(1)(D) of the Code.

For the taxable year ending June 30, 1978, the deductible limit is computed based on the 1978 calendar plan year. For that year, all prior 10-year amortization bases are considered fully amortized, in accordance with section 1.404(a)-14(k) of the regulations. However, an experience loss of $3,000 during 1977 results in a new base for 1978 with a limit adjustment, as of January 1, 1978, of $370. For the 1978, year the deductible limit under section 404(a)(1)(A)(iii) of the Code is $26,004. This is the sum of the $25,000 normal cost and the $370 limit adjustment for the newly established 10-year amortization base as of January 1, 1978, adjusted with interest at the 5 percent valuation rate to June 30, 1978 (the end of the taxable year).

The full funding limitation as of the end of the 1978 plan year is $28,427. This is the excess of:

(A) $162,750, the sum of the $130,000 accrued liability plus the $25,000 normal cost (both compared as of January 1, 1978), adjusted with interest at the 5 percent valuation rate to December 31, 1978, over

(B) $134,323, the $146,450 assets as of January 1, 1978, adjusted with interest at the 5 percent valuation rate to December 31, 1978, minus the $19,450 deduction carryover at the beginning of the year.

Because the full funding limit exceeds the deductible limit determined under section 404(a)(1)(A)(iii) of the Code, the full funding limit does not limit the deduction. Accordingly, for the taxable year ending June 30, 1978, $26,004 is the deductible limit under section 404(a)(1)(A). Although no contribution was made for 1978, a deduction carryover of $19,450 represents contributions made, but not deducted, in prior years which are deductible for 1978. Thus, the carryover of $19,450 is deductible for 1978.

EFFECTIVE DATE

This revenue ruling is effective for plan years to which section 404(a) of the Code (as amended by the Employee Retirement Income Security Act of 1974, Pub L. 93-406, 1974-3 C.B. 1) applies. However, for plan years beginning before June 28, 1982, a contribution will be deductible under section 404(a)(1)(A) if the computation is based on an interpretation of section 404(a)(1)(A) that is reasonable when considered in connection with prior published positions of the Internal Revenue Service.

EFFECT ON OTHER DOCUMENTS

This revenue ruling obsoletes Rev. Rul. 64-159, 1964-1 C.B. (Part 1) 163 and Rev. Rul. 69-255, 1969-1 C.B. 132.

Section 408.—Individual Retirement Accounts

26 CFR 1.408-3: Individual retirement annuities.

Whether the life insurance company or the policyholder is the owner for federal income tax purposes of the mutual fund shares under the circumstances described in the revenue ruling. See Rev. Rul. 82-54, page 11.

---

26 CFR 1.408-3: Individual retirement annuities.

Clarification of certain provisions of Rev. Rul. 81-255, relating to the circumstances in which the policyholders of certain annuity contracts ("wraparound annuities") would be treated for federal income tax purposes as the owners of the mutual fund shares held by the insurance company in connection with those annuities. See Rev. Rul. 82-55, page 12.

Section 421.—General Rules

26 CFR 1.421-8: General rules.

Whether a corporation must recind amendments to an entire option in order to qualify all or part of such option under section 422A of the Code. See Rev. Rul. 82-32, below.

Section 422A.—Incentive Stock Options

26 CFR 14a.422A-1: Questions and answers relating to incentive stock option transitional rules.
(Also Sections 421, 425; 1.421-8, 1.425-1.)

Incentive stock options; qualification; rescission of amendment. A corporation is required to rescind a pre-August 13, 1981, modification of a stock option only with respect to that portion of the option it seeks to qualify as an incentive stock option. However, the remaining portion of the option with respect to which the pre-August 13, 1981, modification need not be rescinded will not qualify for incentive stock option treatment.

Rev. Rul. 82-32 [1]

ISSUE

Must a corporation rescind amendments to an entire option in order to qualify all or part of such option under section 422A of the Internal Revenue Code?

FACTS

Situation 1: A, an individual, is an employee of *X* corporation. In 1978 *X* granted *A* a stock option to purchase $100,000 of *X* company stock. In 1980 *X* amended *A*'s option to add a provision that is a modification of the option within the meaning of section 425(h) of the Code. On July 1, 1982, *X* rescinded the modification with respect to $50,000 of *A*'s option and otherwise properly elected incentive stock option (ISO) treatment for that $50,000 portion. *A* did not own stock possessing more than 10 percent of the total combined voting power of all classes of stock of *X* at the time the option was granted.

Situation 2: B, an individual, is an employee of *Y* corporation. In 1977 *Y* granted *B* an option to purchase 100*x* dollars of *Y* stock. Under the terms of the grant, the option could only be exercised by *B* in installments of 10*x* dollars per year and was not exercisable after the expiration of 10 years from the date the option was granted.

In 1980 *Y* corporation amended *B*'s option to add a provision that is a modification of the option within the meaning of section 425(h) of the Code. When amended, the option price was less than the fair market value of the stock at the time the option was modified. On July 1, 1981, *B* exercised an installment for 10*x* dollars. On June 23, 1982, *Y* rescinded the modification for the unexercised portion of *B*'s option and otherwise properly elected ISO treatment for the unexercised portion. *B* did not own stock possessing more than 10 percent of the total combined voting power of all classes of stock of *Y* at the time the option was granted.

LAW AND ANALYSIS

Section 421(a) of the Code provides, in part, that if a share of stock is transferred to an individual in a transfer in respect of which the requirements of section 422A(a) are met (1) no income will result at the time of the transfer of a share of stock to the individual upon the exercise of an option with respect to the share; (2) no deduction under section 162 (relating to trade or business expenses) will be allowable at any time to the employer corporation, a parent or subsidiary corporation of that corporation, or a corporation issuing or assuming a stock option in a transaction to which section 425(a) applies, with respect to the share so transferred; and (3) no amount other than the price paid under the option will be considered as received by any of such corporations for the share so transferred.

Section 422A(a) of the Code provides that section 421(a) will apply with respect to the transfer of a share of stock to an individual pursuant to the exercise of an incentive stock option if (1) no disposition of the share is made by the individual within 2 years from the date of the granting of the option nor within 1 year after the transfer of the share to the individual, and (2) at all times during the period beginning on the date of the granting of the option and ending on the day 3 months before the date of such exercise, the individual was an employee of either the corporation granting the option, a parent or subsidiary corporation of the corporation, or a corporation or a parent or subsidiary corporation of such corporation issuing or assuming a stock option in a transaction to which section 425(a) applies.

Section 425(h)(1) of the Code provides that if the terms of any option to purchase stock are modified, extended or renewed, the modification, extension, or renewal will be considered as the granting of a new option.

Section 14a. 422A-1, question and answer 9, of the Temporary Income Tax Regulations provides as follows:

Q-9:	If an option granted on or after January 1, 1976, was amended between its date of grant and August 13, 1981, will such an amendment affect the option's eligibility for ISO treatment?
A-9:	An amendment to an otherwise eligible option (or plan) prior to August 13, 1981, will be subject to the rules of section 425(h). If, pursuant to section 425(h), the amendment is a modification, extension, or renewal of the option, such amendment shall be considered as the granting of a new option. In order for such an option to be eligible for ISO treatment, the option (and plan) must comply with the section 422A qualification requirements (see A-2(c)). The option will be deemed to have been granted on the date it was amended. Thus, the option price cannot be less than the fair market value of the stock on that date. If the corporation wishes to retain the original grant price (and grant date) of the option, the corporation may do so by rescinding the amendment that was either a modification, extension, or renewal pursuant to section 425(h), so long as such rescission

---

[1] Also released as News Release IR-82-27, dated February 18, 1982.

occurs prior to the earliest of the exercise of the option, the election of ISO treatment, and August 14, 1982. To be effective, such rescission must apply to the entire option. For example, in the case of a $100,000 option granted in 1978 and amended in 1980, the corporation could not rescind the modification as to only half of the option, and then elect for ISO treatment both $50,000 of the option granted in 1978 and $50,000 of the option as amended in 1980.

In *Situation 1*, pursuant to section 251(c)(1)(B) of the Economic Recovery Tax Act of 1981 (ERTA), Pub. L. 97-34, 1981-2 C.B. 256, 301, *X* is only permitted to designate ISO treatment for $50,000 per year, per employee, of options granted from 1976 through 1980. See section 14a.422A-1, question and answer 6, of the temporary regulations. Since *X* can only designate up to $50,000 of *A*'s option for ISO treatment, *X* need only rescind the 1980 amendment for that portion of the option that *X* is claiming ISO treatment ($50,000). Therefore, it is not necessary for taxpayers to rescind pre-August 13, 1981 amendments for that portion of the option (or plan) they do not intend to qualify for ISO treatment. However, the remaining portion of the option, with respect to which the pre-August 13, 1981 amendments need not be rescinded, will not qualify for ISO treatment. Thus, in *Situation 1*, the rescission by *X* of the 1980 modification with respect to $50,000 of *A*'s option means that the ISO will retain its 1978 grant price and grant date.

In *Situation 2*, *Y* cannot claim ISO treatment for the 10*x* dollar installment of the 1977 option granted to *B* and exercised by *B* in 1981 because that portion of the option, as exercised, did not qualify as an ISO. See section 14a. 422A-1, question and answer 12, of the temporary regulations. Since *Y* cannot rescind the 1980 modification to that exercised portion of the option to qualify it for ISO treatment, *Y* is only required to rescind the 1980 modification to that portion of *B*'s installment obligation that *Y* intends to elect for ISO treatment.

HOLDING

In *Situation 1* and *Situation 2*, the corporations are only required to rescind the modification with respect to that portion of the options that they intend to elect for ISO treatment. Further, neither corporation can elect ISO treatment for the balance of the outstanding options in their modified form. See section 14a. 422A-1, question and answer 9, of the temporary regulations.

---

26 CFR 14a.422A-1: Questions and answers relating to incentive stock option transitional rules.

T.D. 7799

TITLE 26—INTERNAL REVENUE—CHAPTER 1, SUBCHAPTER A, PART 14a—TEMPORARY INCOME TAX REGULATIONS

Questions and answers relating to incentive stock option transitional rules

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document provides temporary regulations relating to the application of incentive stock option (ISO) treatment to certain previously granted stock options. Changes to the applicable tax law were made by section 251 of the Economic Recovery Tax Act of 1981 (95 Stat. 172) (ERTA) [Pub. L. 97-34, 1981-2 C.B. 256, 301], which added new section 422A to the Internal Revenue Code of 1954, entitled "Incentive Stock Options," and provided a set of transitional rules for options granted prior to ERTA's date of enactment. These regulations are intended to provide guidance to all taxpayers who, by application of ERTA §251, will either affirmatively elect incentive stock option treatment or receive such treatment automatically.

EFFECTIVE DATE: The temporary regulations provided by this document are effective after August 12, 1981.

FOR FURTHER INFORMATION CONTACT: Philip R. Bosco of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3288, not a toll-free call.

SUPPLEMENTARY INFORMATION

BACKGROUND

Prior to the enactment of section 422A, the tax treatment of employee stock options generally was governed by section 83 of the Code and the regulations thereunder. Under those rules, the value of a stock option constituted ordinary income to the employee when granted only if the option itself had a readily ascertainable fair market value at that time. If the option did not have a readily ascertainable value when granted, it did not constitute ordinary income at that time. Instead, when the option was exercised, the difference between the value of the stock at exercise and the option price constituted ordinary income to the employee. An employer who granted a stock option generally was allowed a business expense deduction equal to the amount includible in the employee's income in its corresponding taxable year.

Section 422A provides for incentive stock options (ISO's), under which there will be no tax consequences when an ISO is either granted or exercised, and the employee will be taxed at capital gains rates when and if the stock received on exercise of the option is sold. Similarly, no business expense deduction will be allowed to the employer with respect to an ISO.

ERTA §251(c) provides transitional rules relating to ISO treatment. That section limits the applicability of section 422A to options granted on or after January 1, 1976, and outstanding on or after January 1, 1981. In the case of an option granted during the years 1976 through 1980, section 422A will apply only if the employer elects to have the option treated as an ISO. The aggregate value (determined at time of grant) of stock for which an employee may be granted ISO's prior to 1981 may not exceed $50,000 per calendar year and $200,000 in the aggregate for the five-year period 1976-1980. In the case of an option outstanding on August 13, 1981, paragraph (1) of section 425(h) of the Code shall not apply to either any change in the option terms (or the terms of the plan under which the option was granted) or the obtaining of shareholder approval, to permit such option to qualify as an ISO, provided such change and/or shareholder approval occurs on or before August 13, 1982.

These temporary regulations are intended to provide guidance to taxpayers who seek to secure ISO treatment for their existing stock options. The regulations have been drafted in a question and answer format so as to both facilitate their timely publication and limit their scope to the transitional period issues. Of necessity, certain issues have been addressed that will also affect newly created ISO's. No inferences should be drawn, however, regarding issues not raised which may be suggested by a particular question or answer, or as to why certain questions, and not others, are included. A complete set of regulations under section 422A will be forthcoming and will be issued first as a notice of proposed rulemaking. The temporary regulations contained in this document will remain in effect until the forthcoming proposed regulations are published in the Federal Register in final Treasury decision form.

DRAFT INFORMATION

The principal author of these regulations is Philip R. Bosco of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, a new part 14a, Temporary Income Tax Regulations Relating to Incentive Stock Options, is added to Title 26 of the Code of Federal Regulations and the following temporary regulations are adopted:

The following section is added in the appropriate place:

Part 14a TEMPORARY INCOME TAX REGULATIONS RELATING TO INCENTIVE STOCK OPTIONS.

§14a.422A-1 Questions and answers relating to incentive stock option transitional rules.

The following questions and answers relate to the application of incentive stock option (ISO) treatment to certain previously granted stock options, pursuant to section 422A of the Internal Revenue Code of 1954, as added by section 251 of the Economic Recovery Tax Act of 1981 (95 Stat. 172) (ERTA) [Pub. L. 97-34, 1981-2 C.B. 256, 301]:

General Description of Section 422A and Its Transitional Rules.

Q-1: What is the significance of new section 422A of the Code entitled "Incentive Stock Options?"

A-1: Prior to the enactment of section 422A, the tax treatment of employee stock options generally was governed by section 83 of the Code and the regulations thereunder. Under those rules, the value of a stock option constituted ordinary income to the employee when granted only if the option itself had a readily ascertainable fair market value at that time. If the option did not have a readily ascertainable value when granted, it did not constitute ordinary income at that time. Instead, when the option was exercised, the difference between the value of the stock at exercise and the option price constituted ordinary income to the employee. An employer who granted a stock option generally was allowed a business expense deduction equal to the amount includible in the employee's income in its corresponding taxable year.

Section 422A provides for incentive stock options (ISO's). Under this new provision there will be no tax consequences when an ISO is either granted or exercised, and the employee generally will be taxed at capital gains rates when and if the stock received on exercise of the option is sold. Similarly, no business expense deduction will be allowed to the employer with respect to an ISO.

Q-2: What requirements must be met for ISO treatment under section 422A?

A-2: (a) Section 422A provides that the employee, in order to receive ISO treatment, must not dispose of the stock within two years after the option is granted, and must hold the stock itself for at least one year. If all requirements other than these holding period rules are met, tax is deferred until disposition of the stock, but again (in an amount equal to the lesser of (1) the fair market value of the stock on the date of exercise minus the option price or (2) the amount realized on disposition minus the option price) is treated as ordinary income and the employer is allowed a deduction at that time.

(b) In addition, for the entire time from the date of granting the option until three months before the date of exercise (expanded to 12 months if employment ceased due to permanent and total disability), the option holder must be an employee either of the company granting the option, a parent or subsidiary of that corporation, or a corporation (or parent or subsidiary of that corporation) which has assumed the option of another corporation as a result of a corporate reorganization, liquidation, etc. This requirement and the holding period requirement are waived in the case of the death of the employee.

(c) For an option to qualify as an ISO, the following conditions must be set:

(1) The option must be granted under a plan specifying the aggregate number of shares of stock which may be issued and the employees or class of employees eligible to receive the options. This plan must be approved by the stockholders of the granting corporation within 12 months before or after the plan is adopted.

(2) The option must be granted within ten years from the date the plan is adopted or the date the plan is approved by the stockholders, whichever is earlier.

(3) The option must by its terms be exercisable only within ten years of the date it is granted.

(4) The option price must equal or exceed the fair market value of the stock at the time the option is granted. This requirement will be deemed satisfied if there has been a good faith attempt to value the stock accurately, even if the option price is less than the stock value.

(5) The option by its terms must be nontransferable other than at death and must be exercisable during the employee's lifetime only by the employee.

(6) The employee must not, at the time the option is granted, own stock representing more than ten percent of the voting power of all classes of stock of the employer corporation or its parent or subsidiary. However, the stock ownership limitation will not apply if the option price is at least 110 percent of the fair market value (at the time the option is granted) of the stock subject to the option and the option by its terms is not exercisable more than five years from the date it is granted.

(7) The option by its terms is not exercisable while there is outstanding any ISO which was granted to the employee at an earlier time. For this purpose, an option which has not been exercised in full is outstanding until the expiration of the period which under its initial terms it could have been exercised. Thus, the cancellation of an earlier option will not enable a subsequent option to be exercised any sooner.

(8) In the case of options granted after 1980, the terms of the plan must limit the amount of aggregate fair market value of the stock (determined at the time of the grant of the option) for which any employee may be granted ISO's in any calendar year to not more than $100,000 plus a carryover amount. The carryover amount for an employee from any year after 1980 is one-half of the amount by which $100,000 exceeds the value at time of grant of the stock for which ISO's were granted in such prior year. Amounts may be carried over three years. Options granted in any year use up the $100,000 current year limitation first and then the carryover from the earliest year.

(d) Section 422A also provides that:

(1) Stock acquired on exercise of an ISO may be paid for with stock of the corporation granting the option.

(2) The difference between the option price and the fair market value of the stock at the exercise of an ISO is not an item of tax preference.

(3) The employee may have the right to receive additional compensation (in cash or property) at the time of exercise of the ISO so long as the additional amount is subject to inclusion in income under the provisions of sections 61 and 83 of the Code.

(4) An ISO will not be disqualified because of the inclusion of any condition not inconsistent with the qualification requirements.

Q-3: What are the transitional rules relating to ISO treatment under section 422A?

A-3: ERTA §251(c) provides the transitional rules relating to ISO treatment. That section initially limits the applicability of section 422A to options originally granted on or after January 1, 1976.

In the case of an option granted during the years 1976 through 1980, section 422A will apply only if (1) the option was exercised on or after January 1, 1981, or was outstanding on that date, and (2) the employer elects (in such manner as the Treasury Department provides) to have the option treated as an ISO (see A-4). (See A-12 for necessary section 422A qualification requirements.) The aggregate fair market value (determined at time of grant) of stock for which an employee may be granted ISO's prior to 1981 may not exceed $50,000 per calendar year and $200,000 in the aggregate for the five-year period 1976-1980.

In the case of an option granted on or after January 1, 1976, and outstanding on August 13, 1981, paragraph (1) of section 425(h) of the Code shall not apply to either any change in the option terms (or the terms of the plan under which the option was granted) or the obtaining of shareholder approval, to permit such option to qualify as an ISO, provided such change and/or shareholder approval occurs on or before August 13, 1982. (Section 425(h) of the Code requires that if an option is changed, so that it is modified, extended, or renewed, the option shall be treated as newly granted as of the date of such change.)

Election Procedure and Selection of Options.

Q-4: What is the procedure for electing ISO treatment for options granted during the years 1976 through 1980 and outstanding on January 1, 1981?

A-4: NOTE: The following procedure preempts the election procedure set forth in Temporary Regulation §5c.o(d) (TD 7793 46 F.R. 54538 (November 3, 1981) [1981-2 C.B. 62]). If, prior to December 21, 1981, a corporation has filed an election statement that conforms to the requirements of §5c.o(d), such an election statement will be considered to have been properly filed. An election statement filed prior to December 21, 1981, that does not meet the requirements of either §5c.o(d) or this A-4, will not be considered to have been properly filed. In any event, a corporation may re-file the election statement, conforming it to the requirements of this A-4, and such re-filing will then constitute the only election (see A-9, regarding timely rescissions, for a possible reason a corporation may want to refile).

A corporation may file only one election statement and that statement must include all options that are to receive ISO treatment. Thus a corporation that makes an election with respect to certain options granted before 1981 may not make any subsequent election with respect to other options granted before 1981. An election shall be made by attaching a statement to the employer's income tax return (or amended return) for the first taxable year during which either an option subject to the election or an option qualifying under the rules of section 422A is exercised. An election shall be made no later than the due date (including extensions) of the income tax return for such year, except that if the due date occurs before August 14, 1982, the employer will be permitted to make the election at any time prior to August 14, 1982, on a statement attached to an amended return. In any event, no election will be permitted after the due date (taking extensions into account) of the income tax return for the taxable year including December 31, 1982. The statement must—

(a) Contain the name, address, and taxpayer identification number of the corporation.

(b) Identify the election as an election under section 251(c)(1)(B) of the Economic Recovery Tax Act of 1981.

(c) Specify, by employee, the options to which the election applies. For each option so elected, the filing must state the option's date of original grant (and, if applicable, date of most recent modification) and total exercise price (*i.e.*, the total number of shares subject to the option multiplied by the price per share).

All options that are subject to the election must meet the section 422A qualification requirements (see A-2(c)) at the time the election statement is filed. The only exception to this rule is the requirement, when necessary, of securing shareholder approval (see A-32 and A-34).

Q-5: In electing ISO treatment for options granted during the years 1976 through 1980 and outstanding on January 1, 1981, may a corporation select only those options that it wants to receive ISO treatment?

A-5: Yes. However the original grant dates—or later grant dates for options with section 425(h) amendments (see A-9)—of the options selected for ISO treatment will determine the new sequencing order for purposes of the ISO sequential exercise restriction (see A-2(c)(7)). For example consider the case of options granted in 1977, 1978, and 1979, and assume that in 1980 the 1978 option was modified to add a term beneficial to the employee (a modification which under 425(h) would be treated as the granting of a new option). If the 1977, 1978 (as modified), and 1979 options are now elected as ISO's, the sequencing order is as follows: the 1977 option must be exercised first, the 1979 option second, and the 1978 option (as modified) third. See also A-9 and A-38.

Q-6: In electing ISO treatment for options granted during the years 1976 through 1980 and outstanding on January 1, 1981, may a corporation select options on an option-by-option basis and/or an employee-by-employee basis?

A-6: Yes. Subject to the $50,000 per year and $200,000 aggregate limits (see A-3), a corporation may select for ISO treatment any or all options granted to any or all employees, subject only to plan requirements as to who must be benefited under a plan, as among different classes of employees.

Q-7: In electing ISO treatment for options granted during the years 1976 through 1980 and outstanding on January 1, 1981, may a corporation select only a portion of the elected option to receive such treatment?

A-7: Yes. Subject to the $50,000 per year and $200,000 aggregate limits (see A-3), a corporation may select for ISO treatment any portion of any option. If the option is not exercised prior to January 21, 1982, the option must be amended so that the ISO portion is clearly identified. When such a "split" option is exercised, separate stock certificates must be issued (or reissued)—one for the ISO stock and one for the non-ISO stock. See also A-15 and A-18.

Eligibility Requirements and Issues Involving Pre-enactment Modifications, Dollar Limitations, and Dual Plans.

Q-8: Is an option originally granted prior to January 1, 1976, and amended on or after January 1, 1976, eligible for ISO treatment?

A-8: No. For purposes of ISO eligibility, the controlling date is the date of original grant. A modification, extension, or renewal on or after January 1, 1976, of any option originally granted before that date, will not make such option eligible for ISO treatment, regardless of whether or not the option, as so modified, extended, or renewed, would be treated as newly granted within the meaning of section 425(h).

Q-9: If an option granted on or after January 1, 1976, was amended between its date of grant and August 13, 1981, will such an amendment affect the option's eligibility for ISO treatment?

A-9: An amendment to an otherwise eligible option (or plan) prior to August 13, 1981, will be subject to the rules of section 425(h). If, pursuant to section 425(h), the amendment is a modification, extension, or renewal of the option, such amendment shall be considered as the granting of a new option. In order for such an option to be eligible for ISO treatment, the option (and plan) must comply with the section 422A qualification requirements (see A-2(c)). The option will be deemed to have been granted on the date it was amended. Thus, the option price cannot be less than the fair market value of the stock on that date. If the corporation wishes to retain the original grant price (and grant date) of the option, the corporation may do so by rescinding the amendment that was either a modification, extension, or renewal pursuant to section 425(h), so long as such rescission occurs prior to the earliest of the exercise of the option, the election of ISO treatment, and August 14, 1982. To be effective, such rescission must apply to the entire option. For example, in the case of a $100,000 option granted in 1978 and amended in 1980, the corporation could not rescind the modification as to only half of the option, and then elect for ISO treatment both $50,000 of the option granted in 1978 and $50,000 of the option as amended in 1980.

Q-10: An option granted during 1978 was amended during 1980 to add the following features: an alternative stock appreciation right, the right to exercise the option with previously-acquired corporate stock, and the right to receive a cash bonus upon the exercise of the option. At the same time, the exercise period of the option was extended from five to ten years and the post-employment exercise period was extended from 3 to 18 months. If the option is to be elected as an ISO, which of the above amendments is either a modification, extension, or renewal within the meaning of section 425(h) so that the option will be treated as newly granted on the date it was amended?

A-10: Any one of the above amendments will cause the option, pursuant to section 425(h), to be treated as newly granted on the date it was amended.

Q-11: An option granted during 1978 was amended during 1980 to add the right to exercise the option with previously acquired corporate stock. During 1981, the corporation properly elected ISO treatment for the amended option and, pursuant to section 425(h), adjusted the option price upward so that it equaled the fair market value of the stock subject to the option as of the date of the 1980 amendment. During 1982, the employee intends to exercise the option and will pay cash. Under these circumstances, is the employee entitled to exercise the option at the 1978 option price?

A-11: No. The option price, as amended in 1980, is the option price. The application of section 425(h) to option amendments is not affected by whether or not the employee actually benefits from such amendments (but see A-9 regarding timely rescissions).

Q-12: Is an option granted on or after January 1, 1976, and exercised on or after January 1, 1981, eligible for ISO treatment, if, at the time of exercise, the option (or plan) did not meet all of the qualification requirements of section 422A and the transitional rules (see A-2(c) and A-3, respectively)?

A-12: No. Except in cases described in A-13 through A-15, and A-34, in order for an option to be eligible for ISO treatment it must, at the time of exercise, conform to all of the qualification requirements of section 422A and the transition rules. It is not possible to amend an exercised option retroactively, in order to correct nonconforming or missing terms, or to rescind an improper exercise.

Q-13: Is an option granted on or after January 1, 1976, and exercised on or after January 1, 1981, eligible for ISO treatment if, at the time of exercise, the terms of the option did not contain the ISO sequential exercise restriction (see A-2(c)(7))?

A-13: If the option was exercised prior to January 21, 1982, without containing the ISO sequential exercise restriction, such option may still be eligible for ISO treatment. The absence of the restriction will not disqualify an option if the employee in fact had no prior outstanding ISO's at the time the option in question was exercised. If the option was exercised on or after January 21, 1982, the absence of the ISO sequential exercise restriction will not disqualify an option if the employee in fact had no prior outstanding ISO's at the time the option in question was granted. In order to identify prior outstanding ISO's, it will be necessary to take into account all options either elected or qualifying for ISO treatment (see A-5, A-9, and A-38).

Q-14: Is an option granted and exercised during 1981 eligible for ISO treatment if, at the time of exercise, the terms of the plan pursuant to which the option was granted did not contain the $100,000 per year limit on ISO grants (see A-2(c)(8))?

A-14: If the option was exercised prior to January 21, 1982, the absence from the plan of the $100,000 per year limit will not disqualify the option. ISO treatment will only be available, however, for exercised amounts that do not exceed the $100,000 limit. Those amounts in excess of the limit will be treated as non-ISO's. If it is necessary to "split" an exercised option because the $100,000 limit has been exceeded, separate stock certificates must be issued (or reissued) no later than January 21, 1982,—one for the ISO stock and one for the non-ISO stock. If the option was not exercised prior to January 21, 1982, the rules of A-18 will apply.

Q-15: Is an option granted during the years 1976 through 1980, and exercised during 1981, eligible for ISO treatment if, at the time of exercise, the option, either alone or in conjunction with similarly granted options, exceeded the $50,000 per year limit (or the $200,000 aggregate limit) on ISO grants (see A-3)?

A-15: If the option was exercised prior to January 21, 1982, the fact that the aggregate fair market value of the stock exceeded the $50,000 per year limit (or the $200,000 aggregate limit) will not prevent the election of up to $50,000 of the option as an ISO (subject to the $200,000 aggregate limit). Those amounts in excess of the applicable dollar limits cannot be elected as ISO's. If it is necessary to "split" an exercised option because the applicable dollar limits have been exceeded, separate stock certificates must be issued (or reissued) no later than January 21, 1982—one for the ISO stock and one for the non-ISO stock (see also A-7). If the option was not exercised prior to January 21, 1982, the rules of A-18 will apply.

Q-16: Do the $100,000 per year limit (see A-2(c)(8)), and the $50,000 per year and $200,000 aggregate limits (see A-3) apply to all options granted to an employee or only to elected and qualifying ISO's?

A-16: All three limits apply only to elected and qualifying ISO's.

Q-17: Do the $100,000 per year limit (see A-2(c)(8)), and the $50,000 per year and $200,000 aggregate limits (see A-3) apply to the fair market value of the stock granted, or to the option price of the options granted?

A-17: The dollar limits apply to the fair market value of the stock granted. Thus, an employee who is also a 10 percent shareholder would be permitted to receive an ISO grant to purchase $100,000 worth of stock at an option price of $110,000 (see A-2(c)(6)).

Q-18: How do the $100,000 per year limit (see A-2(c)(8)), and the $50,000 per year and $200,000 aggregate limits (see A-3) apply to an option granted on or after January 1, 1976, and not exercised prior to January 21, 1982.

A-18: Such an option will not qualify for ISO treatment if, at the time it is exercised, the option amount is in excess of the applicable dollar limit. In order for such an option to qualify for ISO treatment, it must be "split" into an ISO and a non-ISO portion so that the ISO portion of the option does not exceed the applicable dollar limit. This option "split" must be accomplished prior to the exercise of the original option and the ISO portion of the option must be clearly identified. Any "split" option that was required, by its original terms, to be exercised in full, will still be required to be exercised in full after it is "split." Upon the exercise of a "split" option, separate stock certificates must be issued—one for the ISO stock and one for the non-ISO stock. Additionally, if the option was granted on or after January 1, 1981, the terms of the plan pursuant to which the option was granted must be amended to add the $100,000 per year limit—before the option is exercised.

Q-19: How does the $50,000 per year limit (see A-3) apply to the case of an employee who was granted $100,000 of options in 1979, and who proposes to exercise these options $50,000 in 1982 and $50,000 in 1983?

A-19: Only $50,000 (valued as of the date of grant) of the stock for which options were granted in 1979 will be eligible for ISO treatment. The $50,000 per year limit relates only to the year of grant, not to the year of vesting (as in the case of installment options) or exercise. Additionally, no carryover provision applies to the $50,000 per year limit. Thus, even if the employee had not been granted any options in prior years, the result described above would not change.

Q-20: Is it permissible for a corporation to grant ISO's and non-ISO's under the same plan, or must such options be granted pursuant to separate plans?

A-20: Both ISO's and non-ISO's may be granted pursuant to one plan so long as such plan, by its terms, meets all of the ISO qualification requirements (see A-2(c)). Additionally, each option granted pursuant to such a "dual" plan must be clearly identified as to its status, *i.e.*, ISO or non-ISO.

Q-21: May a single option agreement, issued pursuant to a plan, grant both ISO's and non-ISO's, or must such option agreements grant either only ISO's or only non-ISO's?

A-21: Both ISO's and non-ISO's may be granted pursuant to a single option agreement, so long as each option is clearly identified as to its status, *i.e.*, ISO or non-ISO, and none of the options are subject to a "tandem" exercise arrangement (see A-39).

Q-22: When either amending an existing plan or creating a new plan that is to grant ISO's, is it necessary under the ISO qualification requirements (see A-2(c)) to specify only the aggregate number of total shares issuable under the plan, or must the aggregate numbers of ISO's and non-ISO's be specified?

A-22: Only the aggregate number of total shares issuable under the plan must be specified.

Q-23: Must either an option, or the plan pursuant to which the option is granted, contain a specific provision restricting the exercise of any ISO to within 3 months of termination of the employee's employment (see A-2(b))?

A-23: No. An otherwise eligible option will receive ISO treatment if it is, in fact, exercised within 3 months of termination of the employee's employment (except in cases of disability or death). Moreover, an option term that permits exercise beyond 3 months after termination of employment, will not disqualify an option from receiving ISO treatment.

Q-24: In order for an option to be eligible for ISO treatment, the option price must equal or exceed the fair market value of the stock subject to the option when the option is granted. This requirement will be deemed to have been satisfied if, at the time of grant, there was a good faith attempt to accurately value the stock—even if such valuation should subsequently prove to be in error (see A-2(c)(4)). Do similar good faith rules apply to the $100,000 per year and 50 percent carryover limits (see A-2 (c)(8)), and the $50,000 per year and $200,000 aggregate limits (see A-3) relating to the value of ISO options granted per employee?

A-24: Yes.

Required Option and Plan Amendments.

Q-25: What types of amendments, under the transitional rule governing changes in the terms of options and plans (see A-3), will not invoke the application of section 425(h)?

A-25: The transitional rule waives the applicability of section 425(h) only with respect to amendments which are necessary in order to permit an option or plan to meet the minimum qualification requirements of section 422A (see A-2(c)). Amendments to add or delete permissible terms (such as the right to use previously acquired corporate stock to exercise the option) do not fall within the waiver of section 425(h).

Q-26: Is an option granted after August 13, 1981, under a plan (or option terms) which fails to meet the qualification requirements of section 422A (see A-2(c)), eligible for ISO treatment?

A-26: No. However, prior to being exercised, such an option (or its plan) may be amended to meet the qualification requirements of section 422A and thus become eligible for ISO treatment. All such amendments, where an option is granted after August 13, 1981, will be subject to the rules of section 425(h) (see A-3). Thus, for example, if an option is granted on September 1, 1981, it may qualify as an ISO only if it is amended, and the option price is at least equal to the fair market value of the stock as of the amendment date.

Q-27: May the terms of an outstanding option that was granted on or after January 1, 1981, and that automatically qualified for ISO treatment, be selectively amended so as to disqualify the option from receiving ISO treatment? May the option be cancelled?

A-27: Yes. However, despite either the cancellation of the option or any disqualifying amendment to the option (or the plan pursuant to which the option was granted), the original option will, for purposes of the ISO sequential exercise restriction, be treated as an outstanding ISO until such option, by its original terms, expires by reason of lapse of time (see A-2(c)(7)).

Q-28: May a non-ISO plan be amended so as to qualify only prospectively granted options for ISO treatment?

A-28: Yes. Amendments to a non-ISO plan, so as to meet the section 422A qualification requirements (see A-2(c)), will only apply to previously granted and outstanding options when such amendments, by their terms, are clearly intended to have retroactive affect.

Q-29: If a corporation grants new ISO's in exchange for the cancellation of outstanding non-ISO's, will such an exchange violate either the 422A qualification requirements (see A-2 (c)) or the transition rules (see A-3)?

A-29: No, so long as such an exchange does not constitute a "tandem" exercise arrangement (see A-39).

Shareholder Approval Issues.

Q-30: If a plan received shareholder approval within 12 months before or after the date such plan was originally adopted and it is being amended to conform to the qualification requirements of section 422A (see A-2(c)), will new shareholder approval be required?

A-30: For purposes of the section 422A qualification requirements, new shareholder approval will be required only if the original plan did not specify the aggregate number of issuable shares or identify the eligible employees (or class of employees).

Q-31: Does the amendment of a plan to add the $100,000 per year and 50 percent carryover limits (see A-2(c)(8)), relating to options granted on or after January 1, 1981, require new shareholder approval?

A-31: No.

Q-32: If a plan never received shareholder approval, or did not receive such approval within 12 months before or after the plan was adopted, will such plan conform to the qualification requirements of section 422A (see A-2(c)) if shareholder approval is obtained prior to August 14, 1982?

A-32: Yes, but only if an option granted pursuant to the plan was outstanding on August 13, 1981 (see A-3). If no option granted pursuant to the plan was outstanding on August 13, 1981, such plan must be re-adopted by the granting corporation and, if necessary, amended to meet the section 422A qualification requirements. Shareholder approval must be obtained within 12 months before or after the date the plan is re-adopted. Consequently, any option granted after August 13, 1981, and before the date the plan is re-adopted, will be treated as newly granted on the date of re-adoption of the plan.

Q-33: If an option was granted pursuant to no plan at all and the option was outstanding on August 13, 1981, may a plan now be instituted and shareholder approval obtained, as part of the amendments permitted under the transitional rules (see A-3)?

A-33: Yes.

Q-34: Assuming that shareholder approval is required with respect to certain amendments made to conform an option outstanding on August 13, 1981 (or its plan), to the qualification requirements of section 422A (see A-2(c)), may such option be exercised prior to securing shareholder approval and still be eligible for ISO treatment?

A-34: Yes, so long as shareholder approval is secured within the one-year period specified by the transitional rules (see A-3).

Sequential Exercise Issues.

Q-35: Will the existence (or exercise) of prior stock options which are neither elected nor qualified to receive ISO treatment, ever prevent the exercise of an ISO under the 422A sequential exercise restriction (see A-2)?

A-35: No. However, if an option that is either elected or qualified to receive ISO treatment, contains sequencing restrictions that refer to options other than ISO's, the option will continue to be burdened by such restrictions. The deletion of such non-ISO sequencing restrictions from the option is not an amendment necessary in order to qualify an option for ISO treatment as permitted by the transitional rules (see A-3). Consequently, section 425(h) would be applicable to such an amendment.

Q-36: Under the sequencing rules applicable to section 422 qualified stock options, an option was permitted to be exercised out of sequence so long as it was issued at a higher price than prior outstanding options (section 422(c)(6)). Will a similar exception to the sequencing restriction be applicable to ISO's?

A-36: No. Section 422A does not contain such an exception to the sequencing restriction.

Q-37: How does the section 422A sequential exercise restriction (see A-2(c)(7)) apply to an ISO granted in one year that, by its terms, can only be exercised in installments over a period of years?

A-37: Such an installment ISO is the grant of a single option. The section 422A sequential exercise restriction would restrict the exercise of any later-granted ISO until either the exercise or expiration of all installments of this earlier-granted ISO.

Q-38: Assume that an option granted and exercised during January of 1982 automatically qualifies, by it terms, for ISO treatment. During February of 1982, the same employee exercised a second option, one that had been granted during 1978. Prior to the exercise of the 1978 option, it was amended under the transitional rules (see A-3) so that it would conform to the section 422A qualification requirements (see A-2(c)). If the 1978 option is properly elected to receive ISO treatment (see A-4), will such an election adversely affect the 1982 option's status as an ISO?

A-38: Yes. The election of the 1978 option to receive ISO treatment will automatically disqualify the 1982 option. If the 1982 option is to qualify as an ISO, it cannot be exercised prior to the exercise or expiration of all ISO's previously granted and outstanding on the 1982 option's date of grant (see A-2(c)(7)). When the 1982 option was granted during January of 1982, the 1978 option was already granted and outstanding for purposes of the section 422A sequential exercise restriction.

Receipt of Property or Cash Upon Exercise of an ISO.

Q-39: Section 422A provides that ISO treatment will be available even though the employee has the right to receive cash or other property at the time of the exercise of the option, so long as such property is subject to inclusion in income under section 83 (see A-2(d)(3)). To what extent does section 422A permit the use of tandem options and stock appreciation rights (SARs) in connection with ISO's?

A-39: A tandem stock option, wherein two options are issued together and the exercise of one affects the right to exercise the other, is not permitted because such a tandem option arrangement may be used to evade the section 422A qualification requirements (see A-2(c)).

A tandem ISO-SAR, wherein an ISO and an SAR are granted together and the exercise of one affects the right to exercise the other, is permitted so long as the SAR, by its terms, meets the following requirements:

(a) The SAR will expire no later than the expiration of the underlying ISO.

(b) The SAR may be for no more than 100% of the spread, *i.e.*, the difference between the exercise price of the underlying option and the market price of the stock subject to the underlying option at the time the SAR is exercised.

(c) The SAR is transferable only when the underlying ISO is transferable, and under the same conditions.

(d) The SAR may be exercised only when the underlying ISO is eligible to be exercised.

(e) The SAR may be exercised only when there is a positive spread, *i.e.*, when the market price of the stock subject to the option exceeds the exercise price of the option.

If all of the above requirements are met, for purposes of the 422A sequential exercise restriction (see A-2(c)(7)), a tandem ISO-SAR will be considered exercised in full when either the underlying ISO or the SAR is exercised. Additionally, SAR's may be paid in either cash or property, or a combination thereof, so long as the section 83 income inclusion rule applies to any property so transferred.

There is need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it would be impractical to first issue a notice of proposed rulemaking under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

JOSEPH T. DAVIS,
Acting Commissioner of Internal Revenue.

Approved December 11, 1981.

JOHN E. CHAPOTON,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 17, 1981, 2:10 p.m., and published in the issue of the Federal Register for December 21, 1981, 46 F.R. 61839.)

Section 425.—Definitions and Special Rules [Stock Options]

26 CFR 1.425-1: Definitions and special rules applicable to statutory options.

Whether a corporation must recind amendments to an entire option in order to qualify all or part of such option under section 422A of the Code. See Rev. Rul. 82-32, page 66.

Subchapter E.—Accounting Periods and Methods of Accounting
Part I.—Accounting Periods

Section 442.—Change of Annual Accounting Period

26 CFR 1.442-1: Change of annual accounting period.

Change of annual accounting period from fiscal to calendar year under section 5c.442-1 of the Temporary Income Tax Regulations. See Rev. Proc. 82-25, page 475.

26 CFR 5c.442-1: Temporary regulations relating to change of annual accounting period.

T.D. 7816

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 5c.—TEMPORARY INCOME TAX REGULATIONS UNDER THE ECONOMIC RECOVERY TAX ACT OF 1981

Special rules for change of annual accounting period

AGENCY: Internal Revenue Service

ACTION: Temporary regulations

SUMMARY: This document contains temporary regulations providing special rules for a change of annual accounting period. Changes to the applicable tax law were made by the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256] (ERTA), which reduced the tax rate tables applicable to individuals. These regulations provide special rules that will enable individuals to change their taxable years in order to receive the maximum benefit from the reduction in tax rates. The regulations affect individuals whose annual accounting period is a fiscal year and provide them with the guidance needed to change their annual accounting period to a calendar year.

EFFECTIVE DATE: These regulations apply to requests for a change of accounting period that involve a short period ending on December 31, 1981 or December 31, 1982.

FOR FURTHER INFORMATION CONTACT: Gregory A. Roth of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, (202) 566-3238, not a toll-free call.

SUPPLEMENTARY INFORMATION

BACKGROUND

This document amends the Temporary Income Tax Regulations under the Economic Recovery Tax Act of 1981 (26 CFR Part 5c) by providing special rules under section 442 of the Internal Revenue Code of 1954. These amendments are proposed because of the amendment of sections 1 and 21 of the Internal Revenue Code by section 101 of the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256, 259] (95 Stat. 172). The amendments are issued under the authority of section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

Section 101(a) of ERTA provides a series of reductions in individual income tax rates to take effect for taxable years beginning in 1982, 1983, and 1984. For taxable years beginning after 1984, section 104 of ERTA provides for adjustments to prevent tax increases that are attributable to inflation.

Under section 21(a) of the Code, (relating to the effect of tax rate changes), if a taxpayer's taxable year includes the effective date of a tax rate change (January 1 in the case of the changes made by ERTA), the tax for the year is tentatively determined under both the old and new rates. The actual tax for the year is a pro rata portion of the tax determined under the old rates plus a pro rata portion of the tax determined under the new rates. The portion of the tax taken into account under the old and new rates is based on the number of days in the taxable year before and after the effective date. However, section 101(d)(3) of ERTA amended section 21 of the Code to provide that this rule does not apply to the individual tax rate reductions of ERTA. Thus, a fiscal year taxpayer will not benefit from these rate reductions during the period from January 1 to the end of the fiscal year.

CHANGE OF TAXABLE YEAR

A fiscal year taxpayer may obtain the full benefit of the individual income tax rate reductions of ERTA by changing to a calendar year. However, the regulations under section 442 (relating to change of annual accounting period) require a taxpayer to establish a substantial business purpose for making the change. These regulations provide that in the case of a taxpayer changing to obtain the full benefit of the ERTA tax rate reductions, the substantial business purpose requirement does not apply. Except in the specific cases described in these regulations, the current rules and procedures for change of accounting period (including the consideration given to distortion of income due to deferment of income) will continue to apply. The regulations also permit all individuals to use the expeditious procedure of Rev. Proc. 82-25, page 475, this Bulletin, to obtain the Commissioner's approval of the change. Approval will not be granted unless the taxpayer and the Commissioner agree to the terms, conditions, and adjustments under which the change will be effected. In addition, the time for filing the application for change is extended. Finally, the policy that a change of accounting period is not permitted within 10 taxable years after a previous change except in unusual circumstances does not apply to changes of accounting period permitted under these regulations. However, the regulations do provide that a taxpayer is not permitted to change back to a fiscal year within 5 calendar years after the change to a calendar year.

SPECIAL ANALYSIS

The Commissioner of Internal Revenue has determined that this temporary rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required. For the reasons set forth below no general notice of proposed rulemaking is required by 5 U.S.C. 553(b). Accordingly, no Regulatory Flexibility Analysis is required by chapter 6 of title 5, United States Code.

DRAFTING INFORMATION

The principal author of this regulation is Gregory A. Roth of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and the Treasury Department participated in developing the regulations, both on matters of substance and style.

LIST OF SUBJECTS IN 26 CFR 1.441 – 1.483-2

Income taxes, Accounting, Deferred Compensation plans.

Amendments to the regulations

Accordingly, the following amendments are made to 26 CFR Part 5c:

Paragraph 1. The following section is added at the appropriate place:

§5c.442-1 Temporary regulations relating to change of annual accounting period.

(a) *Applicability*. The rules of paragraph (b) of this section apply to a request for a change of annual accounting period if—

(1) The taxpayer requesting the change of annual accounting period is an individual;

(2) The purpose for the change of annual accounting period is to benefit as of the first day of a calendar year from changes in the individual income tax rates that do not apply until the first day of the taxpayer's taxable year because of section 21(d) (relating to inapplicability of section 21 to changes made by the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256]).

(3) The requested change of annual accounting period is from a fiscal year to a calendar year;

(4) In the case of a principal partner in a partnership formed after April 1, 1954, whose principal partners all change to a calendar year, the partnership changes to a calendar year;

(5) In the case of a shareholder in an electing small business corporation whose shareholders all change to a calendar year, the small business corporation changes to a calendar year; and

(6) The short period involved in the change ends on December 31, 1981 or December 31, 1982.

(b) *Special rules.* In the case of a request for a change of annual accounting period described in paragraph (a) of this section, the following special rules apply:

(1) The substantial business purpose requirement contained in §1.442-1(b) (relating to change of annual accounting period) does not apply.

(2) If the short period involved in the change ends on December 31, 1981, the application for change of annual accounting period may be filled at any time on or before June 15, 1982.

(3) The taxpayer may obtain approval of a change of annual accounting period in the manner set forth in Rev. Proc. 82-25, page 475, this Bulletin.

(4) The taxpayer shall disclose on the application for change of accounting period any partnership formed after April 1, 1954 in which the taxpayer is a principal partner and any electing small business corporation in which the taxpayer is a shareholder.

(5) Approval of the change of annual accounting period will be granted without regard to the number of years that have elapsed since the taxpayer's previous change of annual accounting period.

(6) No subsequent change of annual accounting period will be approved if the short period involved in the subsequent change would end fewer than 5 calendar years after the last day of the short period involved in the change of accounting period described in paragraph (a) of this section. If the short period involved in the subsequent change would end more than 5 calendar years after the last day of the short period involved in the change of accounting period described in paragraph (a) of this section, the Commissioner will determine whether to approve such change—

(i) Without regard to the change of annual accounting period described in paragraph (a) of this section; and

(ii) In the case of a change to the fiscal year used by the taxpayer before the change of annual accounting period described in paragraph (a) of this section, without regard to the number of years that have elapsed since the taxpayer previously adopted such fiscal year.

There is need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it would be impractical to issue it under the notice and comment procedure or subject to the effective date limitation of section 553(b) and (d) of Title 5 of the United States Code.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

ROSCOE L. EGGER, JR.,
Commissioner of
Internal Revenue.

Approved March 29, 1982.

JOHN E. CHAPOTON,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on April 6, 1982, 3:22 p.m., and published in the issue of the Federal Register for April 9, 1982, 47 F.R. 15330)

Part II.—Methods of Accounting
Subpart A.—Methods of Accounting in General

Section 446.—General Rule for Methods of Accounting

26 CFR 1.446-1: General rule for methods of accounting.

Change of method of accounting for bad debts from the specific charge-off method to the reserve method. See Rev. Proc. 82-19, page 463.

26 CFR 1.446-1: General rule for methods of accounting.

Advance consent is granted to change the method of accounting from deducting fully-vested vacation pay in the tax year it is paid to deducting it in the tax year in which it accrues. See Rev. Proc. 82-32, page 486.

Subpart B.—Taxable Year for Which Items of Gross Income Included

Section 451.—General Rule For Taxable Year of Inclusion

26 CFR 1.451-1: General rule for taxable year of inclusion.
(Also Section 128; 5c.128-1.)

Taxable year of inclusion; six-month money market certificate "rolled over" into an All-Savers Certificate. A taxpayer using the cash receipts and disbursements method of accounting must include interest income earned on a six-month money market certificate in gross income in the year the principal and interest are "rolled over" into an "All-Savers Certificate." Rev. Ruls. 80-157 and 81-218 amplified.

Rev. Rul. 82-42

ISSUE

When does a taxpayer include interest earned on a six-month money market certificate in gross income when both the principal and interest are "rolled over" into an "All-Savers Certificate" under the circumstances described below?

FACTS

A, an individual on the cash receipts and disbursements method of accounting, purchased a six-month money market certificate from a qualified institution. The interest income on the certificate was not credited or made available to *A* for withdrawal without penalty prior to the maturity of the certificate.

Prior to the maturity of the six-month money market certificate, *A* "rolled over" the principal and accumulated interest on the money market certificate into a qualified "All-Savers Certificate" with a term of one year and an interest rate lower than that of the money market certificate. Normally, 12 C.F.R. sec. 1204.03 (1981) provides for a penalty for premature withdrawals of time deposits. However, under the current rules of depository institution regulatory agencies, a "roll over" from a six-month money market certificate into a deposit contract having a lower or equal interest rate and a longer or equal term does not subject the depositor to a penalty. Thus, when *A* "rolled over" the six-month money market certificate into the one-year "All-Savers Certificate" with a lower interest rate, no premature withdrawal penalty was imposed and the interest earned on the six-month money market certificate was no longer subject to forfeiture. However, the premature withdrawal penalty provisions of 12 C.F.R. sec. 1204.03 (1981) are applicable to the "All-Savers Certificate."

The principal and interest "rolled over" constituted the principal of the "All-Savers Certificate." The two investments are regarded as separate contracts for income tax purposes. See section 5c.128-1(c)(3), example 9, of the Temporary Income Tax Regulations.

LAW AND ANALYSIS

Section 128(a) of the Internal Revenue Code provides that gross income does not include any amount received by an individual during the taxable year as interest on a depository institution tax-exempt savings certificate.

Section 451(a) of the Code provides that the amount of any item of gross income received by the taxpayer will be included in the gross income of the taxpayer in the taxable year received unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.

Rev. Rul. 81-218, 1981-2 C.B. 43, provides, in part, that if the two investments are not contractually linked and if the purchase of an "All-Savers Certificate" does not entitle the purchaser to benefits not generally available to other individuals, a taxpayer may "roll over" a six-month money market certificate into an "All-Savers Certificate" that will meet the requirements of section 128 of the Code.

Rev. Rul. 80-157, 1980-1 C.B. 186, provides that interest income on a six-month non-negotiable time deposit certificate that is not credited or made available for the holder to withdraw before maturity of the certificate without penalty is not includible in the holder's gross income prior to the redemption or maturity of the certificate.

Here, the six-month money market certificate and the "All-Savers Certificate" issued to *A* upon the "roll over" of the money market certificate are regarded as separate contracts. Thus, the acquisitions of the two investments are two separate transactions for federal income tax purposes. When *A* "rolls over" the principal and accumulated interest on the money market certificate into the "All-Savers Certificate," the "roll-over" is deemed a redemption of the money market certificate for federal income tax purposes. Moreover, as the accumulated interest was used by *A* to purchase a portion of the "All-Savers Certificate," *A* actually received interest income at that time. Accordingly, *A* is required to include the accumulated interest on the money market certificate in gross income in the year of "roll over." However, *A* is entitled to an interest exclusion for such interest received in 1981 in the manner and to the extent provided under section 116.

HOLDING

A taxpayer on the cash receipts and disbursements method of accounting must include interest earned on a six-month money market certificate in gross income in the taxable year in which the principal and interest are "rolled over" into an "All-Savers Certificate." The result here is applicable even though the money market certificate would have matured in a subsequent taxable year.

EFFECT ON OTHER REVENUE RULINGS

Rev. Ruls. 80-157 and 81-218 are amplified.

---

26 CFR 1.451-2: Constructive receipt of income. (Also Section 128; 5c.128-1.)

Interest; All-Savers Certificate; taxable year of inclusion. Factual situations illustrate the includibility of interest earned on All-Savers Certificates.

Rev. Rul. 82-113

ISSUE

When does a taxpayer report interest earned on an All-Savers Certificate under the situations described below?

FACTS

Situation 1. On October 1, 1981, *A*, an individual on the cash receipts and disbursements method of accounting, purchased a qualified All-Savers Certificate. The interest income on the certificate was not credited or otherwise made available by the bank to *A* prior to the maturity of the certificate. *A* received $1,200 in interest in 1982 on the All-Savers Certificate. *A* does not file a joint return under Section 6013 of the Internal Revenue Code.

Situation 2. The facts are the same as in *Situation 1* except that the interest income on the certificate is credited and made available by the bank to *A* at the end of each month. *A* was thus credited with $300 in interest in 1981 from the All-Savers Certificate and $900 in interest in 1982. Although $300 in interest was made available by the bank to *A* in 1981, *A* did not actually withdraw this interest in 1981.

Situation 3. The facts are the same as in *Situation 2* except that *A* purchased the certificate on February 1, 1982. *A* was thus credited with $1,100 in interest in 1982 from the All-Savers Certificate and $100 in interest in 1983. Although $1,100 in interest was made available by the bank to *A* in 1982, *A* did not actually withdraw this interest in 1982.

In all situations, the All-Savers Certificates are subject to a substantial forfeiture provision for early withdrawal.

LAW AND ANALYSIS

Section 128(a) of the Code provides that gross income does not include any amount received by an individual during the taxable year as interest on a depository institution tax-exempt savings certificate ("All-Savers Certificate").

Section 128(b) of the Code provides, in part, that the aggregate amount excludable under section 128(a) for any taxable year shall not exceed the excess of (A) $1,000 ($2,000 in the case of a joint return under section 6013), over (B) the aggregate amount received by the taxpayer that was excludable under section 128(a) for any prior taxable year.

Section 128(f)(1) states that section 116, which excludes from gross income some interest received in 1981, shall not apply to the interest on any depository institution tax-exempt savings certificate.

Section 451(a) of the Code provides that the amount of any item of gross income received by the taxpayer will be included in the gross income of the taxpayer in the taxable year received unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.

Section 1.451-2(a) of the Income Tax Regulations provides that income, although not actually reduced to a taxpayer's possession, is constructively received by the taxpayer in the taxable year credited to the taxpayer's account, set apart for the taxpayer, or otherwise made available to be drawn upon at any time or so that it could have been drawn upon during the taxable year if notice of intention to withdraw had been given.

Section 1.451-2(b) of the regulations provides that the amount of dividends or interest credited on savings bank deposits or to shareholders of organizations such as building and loan associations or cooperative banks is income to the depositor or shareholder for the taxable year when credited. However, if any portion of the dividends or interest is not subject to withdrawal at the time credited, that portion is not constructively received and does not constitute income to the depositor or shareholder until the taxable year in which the portion first may be withdrawn.

Rev. Rul. 80-157, 1980-1 C.B. 186, provides that interest income on a 6-month non-negotiable time deposit certificate that is not credited or made available for the holder to withdraw before maturity of the certificate without penalty is not includible in the gross income of the holder prior to the redemption or maturity of the certificate. However, for certificates on which interest is credited monthly or quarterly, which can be withdrawn immediately without penalty, even though the principal cannot be withdrawn without penalty until maturity of the certificates, the interest must be included in the holder's gross income for the taxable year credited to the account of the holder or made available for withdrawal by the holder.

In *Situation 1*, the interest earned on the All-Savers Certificate is neither paid nor made available to *A* by the bank to withdraw prior to the maturity of the certificate. In *Situation 2* and *Situation 3*, the interest actually earned on the All-Savers Certificate is made available to *A* by the bank monthly as earned.

HOLDINGS

In *Situation 1*, the $1,200 of interest earned by *A* on the All-Savers Certificate, when held to maturity, is reportable by *A* in 1982, the year the certificate matures. In 1982 *A* must include in gross income $200, the amount of interest earned by *A* that exceeds the limitations of section 128(b) of the Code.

In *Situation 2*, the $300 of interest earned and made available in 1981 to *A* is reportable by *A* in 1981. However, because the interest earned and made available does not exceed the limitations of section 128(b) of the Code, *A* may exclude it in 1981. In 1982 $900 of the interest earned is reportable by *A* and *A* must include in gross income $200 ($900 - $700, the balance of the $1,000 section 128(b) exclusion), the amount of interest earned by *A* in 1982 that exceeds the limitations of section 128(b) of the Code.

In *Situation 3*, the $1,100 of interest earned and made available in 1982 to *A* is reportable by *A* in 1982. Further, because the interest earned and made available exceeds the limitations of section 128(b) of the Code, *A* must include in gross income in 1982 $100 ($1,100 - $1000, the section 128(b) exclusion). In 1983, *A* must include $100 in gross income since the entire 128(b) exclusion was used in 1982.

---

26 CFR 1.451-2: Constructive receipt of income.
(Also Section 61; 1.61-2.)

Taxable year of inclusion; constructive receipt of income. The surrender of the related option upon exercise of a stock appreciation right (SAR), where the amount receivable upon the exercise of the SAR is limited to the price per share at which the related option could have been exercised on the exercise date, is the loss of a valuable right and, therefore, is a substantial limitation that precludes constructive receipt of income by virtue of the appreciation of the employer's stock. Rev. Rul. 80-300 amplified.

Rev. Rul. 82-121

ISSUE

When is an employee in receipt of income under the circumstances described below?

FACTS

In 1980, *X* corporation adopted a stock option plan that provides for the granting of nonqualified stock options and related stock appreciation rights (SAR's) to employees of *X*. Each grant of an option will be accompanied by an SAR. A nonqualified stock option allows an employee, for a given period of time, to acquire a share of *X* corporation stock at its fair market value on the date the option was granted. Under the plan, exercise of a stock option results in cancellation of the related SAR. An SAR permits the employee to elect at any time during the term of the related stock option to receive a cash payment equal to the difference between the fair market value of the option stock on that date and its exercise price. However, payment pursuant to the SAR cannot exceed an amount equal to the option price of the stock. When an employee exercises an SAR, the employee's right to purchase a share of *X* stock by exercise of the related option is cancelled, thus cancelling the right to future appreciation with respect to such share.

In 1980, *X* granted 5 nonqualified stock options with related SAR's to *A*, an individual employee of *X*. On the date of the grant, the fair market value of *X*'s common stock was 20*x* dollars a share. On May 1, 1981, the fair market value of *X*'s common stock reached 40*x* dollars a share. In 1982, *A* exercised the options when the fair market value of a share of *X*'s common stock was 50*x* dollars. *A* paid 100*x* dollars and received stock with a fair market value of 250*x* dollars (5 × 50*x*).

LAW AND ANALYSIS

Under section 61 of the Internal Revenue Code, gross income means all income from whatever source derived, except as otherwise provided by law.

Section 451 of the Code states that the amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.

Section 1.451-2 of the Income Tax Regulations states that income although not actually reduced to a taxpayer's possession is constructively received in the taxable year during which it is credited to the taxpayer's account, set apart, or otherwise made available so that the taxpayer may draw upon it at anytime, or so that the taxpayer could have drawn upon it during the taxable year if notice of intention to withdraw had been given. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

In Rev. Rul. 80-300, 1980-2 C.B. 165, a corporation granted to its key employees stock appreciation rights that entitled them to a cash payment for each right exercised equal to the excess of the fair market value of a share of a corporation's common stock on the date of exercise over the fair market value of a share on the date the right was granted.

The revenue ruling held that an employee possessing stock appreciation rights is not in constructive receipt of income by virtue of the appreciation of the employer's stock because the employee's right to benefit from further appreciation of stock without risking any capital is a valuable right, the forfeiture or surrender of which is a sufficient restriction precluding the doctrine of constructive receipt. Rev. Rul. 80-300 also held that the cash payment to which the employee is entitled is includible in gross income in the year the SAR is exercised.

In order to exercise the SAR's, *A* must surrender the related options and thereby forfeit the right to benefit from any appreciation of the optioned stock in excess of the price at which the related option could have been exercised. In this case, the loss of the stock option purchase rights is the loss of a valuable right and, therefore, is a substantial limitation that precludes the constructive receipt of the appreciation in the SAR when it first reached its maximum value (20*x* dollars) on May 1, 1981. Accordingly, *A* will not be in receipt of income until the options are exercised in 1982.

HOLDING

A is not in constructive receipt of income by virtue of the appreciation of *X*'s stock. *A* must include 150*x* dollars (250*x* − 100*x*) in gross income in 1982 because the options were exercised in that year.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 80-300 is amplified.

---

26 CFR 1.451-6: Election to include crop insurance proceeds in gross income in the taxable year following the taxable year of destruction or damage.

Whether the Federal Crop Insurance Corporation (FCIC) is required under section 6041 of the Code to file information returns for payments to farmers of crop insurance proceeds. See Rev. Rul. 82-93, page 196.

Section 453B.—Gain or Loss Disposition of Installment Obligations

Disposition of an installment obligation. The increase in the interest rate on an installment obligation coupled with the substitution of a new obligor does not constitute a disposition of the installment obligation. Rev. Rul. 75-457 amplified.

Rev. Rul. 82-122

ISSUE

Under the circumstances described below, will the substitution of a new obligor and a change in the rate of interest be considered a satisfaction or disposition of an installment obligation within the meaning of section 453B(a) of the Internal Revenue Code?

FACTS

In 1980 the taxpayer sold real property to *A* for 550*x* dollars. Taxpayer received 150*x* dollars in cash and a note and mortgage in the amount of 400*x* dollars. The note provides for annual interest at 13 percent and equal monthly payments of principal for a period of 10 years. The note further provides that, unless the taxpayer consents, the note will become fully due and payable if the property is sold or otherwise transferred by *A* prior to the note being fully paid. The taxpayer has reported gain realized from the sale on the installment method under section 453 of the Code.

In 1981 *A* sold the property to *B*, who, with the taxpayer's consent, assumed the mortgage held by the taxpayer. The taxpayer and *B* agreed to increase the interest rate to 15 percent. The monthly payments were accordingly increased to reflect the higher rate of interest and *A* was released from further liability on the note. No other changes were made in the terms and conditions of the original note.

LAW AND ANALYSIS

Section 453B(a) of the Code provides that if an installment obligation is satisfied at other than its face value or distributed, transmitted, sold, or otherwise disposed of, gain or loss shall result to the extent of the difference between the basis of the obligation and (1) the amount realized, in the case of satisfaction at other than face value or a sale or exchange, or (2) the fair market value of the obligation at the time it is distributed, transmitted, or disposed of other than by sale or exchange. This provision was previously contained in section 453(d), before Pub. L. 96-471, 1980-2 C.B. 489, added a new section to the Code dealing exclusively with the disposition of installment obligations.

In Rev. Rul. 68-419, 1968-2 C.B. 196, the buyer purchased stock with a note providing for five, equal annual payments. The buyer encountered financial difficulties and asked the seller to modify the note by deferring each payment for 5 years. The seller agreed and in return the buyer agreed to increase the interest rate from 6 to 7 percent. Rev. Rul. 68-419 holds that these modifications of the note are not to be considered a disposition or satisfaction of an installment obligation within the meaning of section 453(d) of the Code. Similarly, see *Rhombar Co. v. Commissioner*, 47 T.C. 75 (1966), *acq.*, 1967-2 C.B. 3, *aff'd on other grounds*, 386 F.2d 510 (1967), in which the court held that a taxpayer corporation was not in constructive receipt of payments owed under the terms of an installment obligation when the corporation agreed to postpone the due dates of the payments and take a higher rate of interest on the amounts owed. The court observed that the parties dealt at arm's length, the modification of terms benefited both parties, the deferral was requested for a valid business purpose, and there was no tax avoidance motive on the taxpayer's part.

In Rev. Rul. 74-157, 1974-1 C.B. 115, the taxpayer sold a parcel of land for cash and a promissory note secured by a deed of trust on the land. Because the purchaser wanted to divide the property into two parcels, the seller agreed to accept substitution of two promissory notes, each secured by a deed of trust on a parcel of land for the original unpaid note and deed. The revenue ruling holds that the substitution of the deeds and notes is not a satisfaction or disposition of an installment obligation under section 453(d) of the Code.

In Rev. Rul. 75-457, 1975-2 C.B. 196, a taxpayer sold real estate to individual *A* for cash, a deed of trust, and a promissory note providing for monthly payments over a 15-year term. The terms of the deed and note allowed *A* to resell the property, provided that the subsequent buyer executed a new note under the same terms and conditions as the original deed of trust. *A* subsequently sold the property to *B*, who assumed the obligation by executing a new deed of trust and note in favor of the taxpayer under the same terms and conditions as the original deed of trust and note. *A* was released from liability on the original note. Rev. Rul. 75-457 holds that the substitution of obligors, deeds of trust, and promissory notes, without any other changes, was not to be considered a satisfaction or disposition of an installment obligation under section 453(d) of the Code. A satisfaction or disposition under section 453(d) occurs when the rights of the seller under the installment sale disappear or are materially changed so that the need to postpone recognition of gain ceases. See *Cunningham v. Commissioner*, 44 T.C. 103 (1965), *acq.*, 1966-2 C.B. 4, in which the taxpayer sold shares of corporate stock to a corporation for cash and an installment obligation payable over 10 years. The buyer subsequently sold the stock to another corporation which assumed liability for the obligation. The court held that the change in the obligor on the note was not a disposition of an installment obligation under section 453(d) because the rights of the seller were not materially changed and the seller held essentially the same note.

Actions of the obligor that result in a change in the installment obligation, such as a transfer to a third party or a change in the form of the note, are not ordinarily treated as a disposition because the effect is merely to continue the seller's right to receive installment payments, without substantially changing the rights arising from the original transaction. Furthermore, an increase in the interest rate that the parties bargained for is not a material change in the obligation.

In the present situation, the terms of the note held by the taxpayer were changed when *A*, the initial obligor, sold the property to B. The taxpayer will be paid a higher rate of interest in return for releasing *A* from liability and allowing *B* to assume the mortgage. Based on Rev. Rul. 68-419, Rev. Rul. 74-157, and Rev. Rul. 75-457, the changes in the obligor, and the interest rate neither eliminate nor materially alter the rights of the taxpayer.

HOLDING

The substitution of a new obligor on the note and an increase in the interest rate, together with an increase in the amount paid monthly to reflect the higher interest rate, will not be considered a satisfaction or disposition of an installment obligation within the meaning of section 453B(a) of the Code.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 75-457 is amplified.

Section 455.—Prepaid Subscription Income

26 CFR 1.455-1: Treatment of prepaid subscription income.

Prepaid subscription income; postage and handling charges. Income from prepaid postage and handling charges received in connection with prepaid magazine subscriptions is properly treated as prepaid subscription income to which an election under section 455 of the Code applies.

Rev. Rul. 82-68

ISSUE

Is income from prepaid postage and handling charges received by a taxpayer in connection with prepaid magazine subscriptions treated as "prepaid subscription income" to which an election under section 455 of the Internal Revenue Code applies?

FACTS

The taxpayer, a corporation, is a magazine publisher that reports its income for federal income tax purposes on an accrual method of accounting. The taxpayer offers subscribers an opportunity to elect subscription periods of from 1 to 3 years. In order to show its subscribers that steadily increasing postage rates are the primary cause of the magazine's increased subscription prices, the taxpayer separately states on its invoices to its subscribers the amounts it spends for postage and handling during the life of the subscription. The taxpayer treats the prepaid postage and handling charges as "prepaid subscription income" within the meaning of section 455 of the Code and includes these amounts in gross income over the tax years of the subscription. The taxpayer has made a proper election under section 455(c) of the Code.

LAW AND ANALYSIS

Section 455(a) of the Code provides that prepaid subscription income is included in gross income for the tax years during which a liability to furnish or deliver a newspaper, magazine, or other periodical exists.

Section 455(c) of the Code provides that section 455 applies to prepaid subscription income only if the taxpayer makes an election under this section.

Section 455(d)(1) of the Code provides that the term "prepaid subscription income" means an amount that is includible in gross income; is received in connection with, and directly attributable to, a liability that extends beyond the close of the taxable year in which the amount is received; and is income from a subscription to a newspaper, magazine, or other periodical.

Section 1.455-5(a) of the Income Tax Regulations provides that prepaid subscription income includes the amounts actually received by the taxpayer in connection with its liability to furnish or deliver the newspaper, magazine, or other periodical.

In the present case, although the taxpayer separately states on its invoices the postage and handling charges and the basic subscription price of the magazine, the postage and handling charges are an amount includible in the taxpayer's gross income received in connection with and directly attributable to the taxpayer's liability to furnish or deliver magazines to its subscribers, a liability that extends beyond the close of the tax year in which the charges are received.

HOLDING

Income from prepaid postage and handling charges received by the taxpayer in connection with prepaid magazine subscriptions is properly treated as prepaid subscription income to which the taxpayer's election under section 455 of the Code applies.

Any change from a taxpayer's present method of accounting for prepaid postage and handling charges to the method described in this revenue ruling constitutes a change in method of accounting to which the provisions of sections 446 and 481 of the Code apply.

Subpart C.—Taxable Year for Which Deductions Taken

Section 465.—Deductions Limited to Amount At Risk

Losses; limitation; amount at risk; motion picture film. An investor purchased the title to a used movie and the right to exploit the movie in the nontheatrical media throughout the U.S. Under the terms of the purchase agreement, the investor will not be personally liable on the note if the Service determines that certain tax benefits identified by the shelter promoter are unavailable. The investor will be treated as if the investor had borrowed the base amount of the note on a nonrecourse basis for purposes of determining the amount at risk.

Rev. Rul. 82-123

ISSUE

What amount of the taxpayer's investment is at risk under the circumstances described below?

FACTS

In 1980 *P*, who owned nontheatrical exhibition rights in and to certain used motion pictures, offered to sell to individuals *P*'s right, title, and interest in perpetuity. The purchase price, which varied with the movie selected, was payable by a 15 percent cash down payment and a note for the balance, with interest, due and payable 10 years from the date of purchase.

Payments on the note were required to the extent of 50 percent of the gross proceeds from the distribution of the movie, with any remaining balance due at the end of the 10-year period. The investor was personally liable on the note. *P*, however, agreed to let investors elect to change the liability to nonrecourse if the Appellate Division of the Internal Revenue Service should determine that any of the tax benefits set forth in the prospectus were not available to the investor.

LAW AND ANALYSIS

Section 465(a)(1) of the Internal Revenue Code provides that in the case of an individual, an electing small business corporation (as defined in section 1371(b)), and a corporation with respect to which the stock ownership requirement of section 542(a) is met, engaged in an activity to which section 465 applies, any loss from such activity for the taxable year shall be allowed only to the extent of the aggregate amount with respect to which the taxpayer is at risk for such activity at the close of the taxable year.

Section 465(b)(1) of the Code provides that for purposes of section 465 the amounts with respect to which a taxpayer shall be considered at risk for an activity shall include the amount of money and the adjusted basis of other property contributed by the taxpayer to the activity, and amounts borrowed with respect to such activity (as determined under section 465(b)(2).

Section 465(b)(2) of the Code provides that for purposes of section 465 a taxpayer shall be considered at risk with respect to amounts borrowed for use in an activity to the extent that the taxpayer is personally liable for the repayment of such amounts, or has pledged property, other than property used in such activity, as security for such borrowed amounts (to the extent of the net fair market value of the taxpayer's interest in such property).

In applying section 465, substance will prevail over form. Regardless of the form a transaction may take, a taxpayer's amount at risk will not be increased if the transaction is a device to avoid the purpose of section 465. Transactions which are not consistent with normal commercial practice will be examined closely in order to determine the substance of the transaction.

The note described in the present case may be changed, at the investor's election, from recourse to nonrecourse if the Appellate Division of the Internal Revenue Service should determine that any of the tax benefits set forth in the prospectus are not available to the investor. This right to convert the note from recourse to nonrecourse is conditioned on a denial of tax benefits by the Internal Revenue Service and is not dependent on a finding that the property has developed to the point that it has sufficient value to support the debt obligation.

Under these circumstances, the primary reason for requiring the investor to be personally liable on the note is not to secure payment of the note but is to increase the investor's "at risk" position and, thereby, allow the investor to claim all deductions generated from the distribution of the motion pictures. The primary reason for allowing the investor to convert the note into a nonrecourse liability is not because the property has become adequate security for the note, but because the promised tax benefits have not materialized. The property, at that time, may have little or no value.

Because the above described financing arrangement is entered into primarily to avoid the limitations of section 465 of the Code and not primarily for business reasons, the investor will be treated as if the investor had borrowed the face amount of the note on a nonrecourse basis, repayable only from the investor's interest in the activity.

HOLDING

The investor is at risk only to the extent of the 15 percent cash down payment.

Subpart D.—Inventories

Section 472.—Last-In, First-Out Inventories

26 CFR 1.472-1: Last-in, first-out inventories.

LIFO; price indexes; department stores. The January 1982 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods of valuing inventories for tax years ended December 31, 1981, and January 31, 1982.

Rev. Rul. 82-73

The following price indexes for January 1982 published by the Bureau of Labor Statistics on February 26, 1982, for use by department stores are accepted by the Internal Revenue Service under section 1.472-1(k) of the Income Tax Regulations and Rev. Proc. 72-21, 1972-1 C.B. 745, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended December 31, 1981, and January 31, 1982.

Indexes are given on a national basis for the store total, for 20 major groups of departments, and for two special combinations—soft and durable goods. The store total index covers all departments, including some not listed separately, with the following exceptions: candy, foods, liquor, tobacco, paints, and wallpaper, as well as contract departments.

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE
INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS
(January 1941 = 100)

Department group	January 1981	January 1982	Percentage Change from January 1981 to January 1982 [1]
I Piece Goods	376.5	379.0	0.7
II Domestics and Draperies	438.7	484.0	10.3
III Women's and Children's Shoes	515.0	532.1	3.3
IV Men's and Boys' Shoes	633.0	665.0	5.1
V Infants' and Wear	420.7	444.7	5.7
VI Women's Underwear	345.1	370.0	7.2
VII Women's and Girls' Hosiery	204.7	215.3.	5.2
VIII Women's and Girls' Accessories	386.8	398.6	3.1
IX Women's Outerwear and Girls' Wear	323.3	319.0	−1.3
X Men's Clothing	416.7	431.4	3.5
XI Men's Furnishings	405.0	431.3	6.5
XII Boys' and Clothing and Furnishings	387.7	389.1	.4
XIII Jewelry	711.5	690.6	−2.9
XIV Notions	407.1	423.7	4.1

	Department group	January 1981	January 1982	Percentage Change from January 1981 to January 1982 [1]
XV	Toilet Articles and Drugs	481.9	526.2	9.2
XVI	Furniture and Bedding	468.5	495.3	5.7
XVII	Floor Coverings	371.4	411.3	10.7
XVIII	Housewares	647.0	700.0	8.2
XIX	Major Appliances	216.1	231.4	7.1
XX	Radio and Television	117.5	118.2	.6
	Groups I – XV: Soft Goods	412.9	429.6	4.0
	Groups XVI – XX Durable Goods	402.2	428.9	6.6
	Store Total	409.6	428.9	4.7

[1] Absence of a minus sign before percentage change in this column signifies price increase.

---

26 CFR 1.472-8: Dollar-value method of pricing LIFO inventories.

T.D. 7814

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953.

Dollar-Value LIFO Inventories—Use of government price indexes

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the valuation of dollar-value last-in, first-out (LIFO) inventories. These regulations provide the public with guidance regarding a method of valuing dollar-value LIFO inventories and would affect taxpayers required to maintain inventories.

DATES: The amendments are to be effective for taxable years beginning after December 31, 1981.

CONTACT FOR FURTHER INFORMATION: Philip R. Bosco of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington D.C. 20224, Attention; CC:LR:T, 202-566-3288, not a toll-free call.

SUPPLEMENTARY INFORMATION—FINAL REGULATORY FLEXABILITY ANALYSIS

BACKGROUND

This document contains final amendments to the Income Tax Regulations (26 CFR Part 1) under section 472 of the Internal Revenue Code of 1954. These amendments conform the existing regulations under section 472 to that Code section as amended by P.L. 97-34 [1981-2 C.B. 256] and are issued under the authority contained in sections 472 and 7805 of the Internal Revenue Code of 1954 (68A Stat. 159, 917; 26 U.S.C. 472, 7805).

On January 16, 1981, the FEDERAL REGISTER published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 472 of the Internal Revenue Code of 1954, 46 FR 3912 [LR-267-79, 1981-1 C.B. 757]. The amendments were proposed to simplify the use of the dollar-value LIFO method by providing that taxpayers may establish inventory pools under special rules and may compute an inventory price index for valuing a pool by referring to a stated percentage of the percent change in selected consumer or producer price indexes prepared by the Bureau of Labor Statistics and published in the *CPI Detailed Report* or *Producers Prices and Price Indexes*, which are monthly reports on consumer and producer price movements. A public hearing on the proposed amendments was requested and was held on June 30, 1981. After consideration of all comments regarding the proposed amendments, those amendments are adopted as revised by this Treasury decision. The preamble to the notice of proposed rulemaking summarizes and explains the proposed amendments. The remainder of this preamble discusses the major comments from the public and changes to the proposed regulations.

PUBLIC COMMENTS AND CHANGES TO THE PROPOSED REGULATIONS

The proposed regulations provided that the regulations would be applicable for taxable years beginning after they were adopted. Several commentators suggested that the regulations should be made applicable to taxable years beginning after the date the regulations become final. The Treasury decision modifies the effective date of the regulations to be applicable for taxable years beginning after December 31, 1981.

In developing the proposed regulations, it was determined that the consumer and producer price indexes prepared by the Bureau of Labor Statistics would overstate the movement of inventory prices experienced by some taxpayers and would understate the movement of inventory prices experienced by other taxpayers. Taxpayers experiencing a rate of inventory price inflation lower than the published rate would tend to choose the use of the published consumer and producer price indexes. Taxpayers experiencing a rate of inventory price inflation higher than the published rate would tend to choose to use a price index based on their own inventory price inflation experience. It was decided that the use of the consumer and producer price indexes prepared by the Bureau of Labor Statistics should not depend on whether a taxpayer's actual rate of inventory price inflation was relatively high or low. However, it was also decided that the use of overstated inflation rates to value LIFO inventory pools should be reduced to the extent possible consistent with the purposes of simplifying the use of the dollar-value LIFO method. Therefore, the proposed regulations provided that a taxpayer would be limited to 80 percent of the percent change in the applicable CPI or PPI indexes. Several commentators argued for use of 100 percent of the applicable indexes. The 80 percent limitation is intended to be an alternative to computing an inventory price index based on the taxpayer's own inflation rate and is intended to be an appropriately conservative estimate that the taxpayer can use without regard to the inflation rate actually experienced by the taxpayer. However, since small businesses, as a practical matter, are unable to compute their own inflation experience and therefore do not have the opportunity to choose to use their own inflation experience, the Treasury decision modifies the 80 percent limitation and allows an eligible small business, as defined by section 474(b) of the Code, to use 100% of the percent change in the applicable indexes. All other taxpayers would be limited to 80 percent of the percent change in the applicable indexes.

The proposed regulations provided that a taxpayer must use the most detailed CPI or PPI indexes available for the goods in its various LIFO pools. Several commentators argued that such a requirement would necessitate inventory records at a level of detail beyond the needs and capabilities of the majority of taxpayers who would benefit most from the use of published indexes. The Treasury decision modifies this requirement. A taxpayer will be required to use the most detailed index only when 10 percent or more of the value of the taxpayer's inventory falls within such an index category. If 10 percent of inventory value does not fall within an index category, the next less detailed index category that does include 10 percent of the inventory value will be used. The index for that 10 percent separate index category will be a weighted average of the detailed indexes for the category items comprising the 10 percent separate index category that are actually present in the taxpayer's inventory. For purposes of calculating this separate index, the detailed items will be weighted according to the weights used by BLS.

The use of BLS weights is limited only to the determination of the appropriate index for a separate index category. In computing the overall index for a particular pool, the taxpayer will weight the appropriate indexes for the separate index categories comprising the pool according to the taxpayer's actual inventory weights for such index categories. The Internal Revenue Service intends to publish the BLS weights as well as illustrations of the various computations.

An issue left undecided in the proposed regulations was how the 80 percent limitation should be applied to the inflation rate for a period of more than one taxable year; that is, should it be applied to the annual inflation rate or to the cumulative inflation rate. The Treasury decision provides that the limitation should be applied to the cumulative published inflation rate.

Other comments were received suggesting that additional dollar-value LIFO issues should be addressed. It was decided that the resolution of such issues in these regulations would unduly lengthen and complicate the regulations.

ADDITIONAL INFORMATION

Evaluation of the effectiveness of the regulations after issuance will be based on comments received from offices within the Internal Revenue Service and the Treasury Department, other governmental agencies, state and local governments, and the public.

These regulations will affect any small business that is required under section 471 of the Internal Revenue Code to maintain inventories, elects to use the LIFO method in valuing such inventories, and wishes to use the rules provided by the proposed amendments. No taxpayer will be required to use the method provided by the proposed amendments.

These regulations require any small business wishing to use the rules provided by the proposed amendments to report for the first year that the method is used the inventory pools used, the type of goods included in each pool, and the consumer or producer price index or indexes selected for each pool. In addition, for each year in which the inventory price index computation method is used, the taxpayer will be required to maintain adequate books and records showing how inventory pools were established, how the consumer and producer price indexes were selected, and how the inventory price indexes and the change in such indexes were computed. Professional accounting skills may be desirable in the initial year of using the method provided by the proposed rules, although information disseminated by various industry groups may provide small businesses with adequate assistance. Otherwise, the rules prescribed in the proposed amendments do not require any professional skills in addition to those already needed to keep inventory accounting records for a small business.

These regulations are being proposed to reduce the economic impact on small businesses of the rules relating to the use of the LIFO method by simplifying the computations required under such method, thereby enabling more small entities to avail themselves of the tax reduction benefits of the use of the LIFO method and reducing the computational and recordkeeping costs of taxpayers using the LIFO method.

DRAFTING INFORMATION

The principal author of these regulations is Philip R. Bosco of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of amendments to the regulations

The following amendments to 26 CFR Part 1 are adopted:

Paragraph (e) of §1.472-8 is amended by adding new paragraph (e)(3) to read as set forth below:

§1.472-8 Dollar-value method of pricing LIFO inventories.

* * * * *

(e) *Methods of computation of the LIFO value of a dollar-value pool.****

(3) *Use of inventory price index computed with reference to consumer or producer price indexes—(i) In general.* For purposes of paragraph (e)(1) of this section, for taxable years beginning after December 31, 1981, an inventory price index computed in the manner provided by paragraph (e)(3) will be accepted by the Commissioner as an appropriate method of computing an index, and the use of such inventory price index to compute the LIFO value of a dollar-value inventory pool will be accepted as accurate, reliable, and suitable. A taxpayer using the inventory price index computation method provided by paragraph (e)(3) must use such method in determining the value of all goods for which the taxpayer has elected to use the LIFO method. However, the inventory price index computation method provided by paragraph (e)(3) may not be used by a taxpayer eligible to use inventory price indexes prepared by the United States Bureau of Labor Statistics for the purpose of valuing the LIFO inventories of a specific industry. Thus, a taxpayer eligible to use the retail price indexes prepared by the Bureau of Labor Statistics and published in *Department Store Inventory Price Indexes* may not use the inventory price index computation method provided by paragraph (e)(3). An inventory price index computed as provided by paragraph (e)(3) is computed in the manner provided by paragraph (e)(3)(ii) with reference to consumer or producer price indexes selected in the manner provided by paragraph (e)(3)(iii). Special rules for establishing inventory pools to be valued by an inventory price index computed in the manner provided by paragraph (e)(3) are in paragraph (e)(3)(iv). Rules relating to the adoption of, or change to, the method of computing an inventory price index in the manner provided by paragraph (e)(3) are in paragraph (e)(3)(v) and (vi).

(ii) *Computation of index.* An inventory price index computed in the manner provided by this (ii) shall be a stated percentage of the percent change in the selected consumer or producer price index or indexes for a specific category or categories of goods. The stated percentage for a taxpayer in a taxable year in which it is an eligible small business, as defined by section 474(b) of the Code, shall be 100 percent of the percent change in the selected price indexes. The stated percentage for all other taxpayers shall be 80 percent of the percent change in the selected price indexes. See paragraph (e)(3)(iii) of this section for rules relating to the selection of appropriate consumer or producer price indexes. Thus, if the selected consumer or producer price index for a specific category of goods increased 10 percent for the period December 1981 to December 1982, an inventory price index computed in the manner provided by this (ii) with reference to such consumer or producer price index will reflect an increase of either 10 percent for an eligible small business or 8 percent (80 percent of 10 percent) for all other taxpayers. If the selected consumer or producer price index for a specific category of goods increased 10 percent per year for the period December 1981 to December 1983, an inventory price index computed in the manner provided by this (ii) with reference to such consumer or producer price index will reflect an increase of either 21 percent for an eligible small business or 16.8 percent (80 percent of 21 percent) for all other taxpayers. If under paragraph (e)(3)(iii) it is necessary to select more than one specific consumer or producer price index for an inventory pool, the stated percentage of the percent change in such indexes is the stated percentage of the weighted average percent change for such indexes. Such weighted average is computed with reference to the relative amounts of costs in the inventory pool for each index category of goods. The costs to be used in computing such weighted average must be the relative current-year costs in ending inventory.

(iii) Selection of consumer or producer price indexes—(A) *In general.* An inventory price index computed as provided by paragraph (e)(3) of this section is computed with reference to the consumer or producer price indexes for specific categories of inventory items in the *CPI Detailed Report* or *Producer Prices and Price Indexes* published by the United States Bureau of Labor Statistics.

(B) *Selection of indexes by category of inventory items.* The selection of consumer or producer price indexes for an inventory pool is accomplished via a two-step process. First, the inventory items in each pool should be classified according to the detailed listings in the appropriate tables of the *CPI Detailed Report* or in *Producer Prices and Price Indexes* and assigned an index category. Second, an appropriate consumer or producer price index must be determined for each index category to which inventory items have been assigned. The assignment of index categories to the taxpayer's inventory items is accomplished by a process of elimination as follows:

(*1*) Whenever a specific inventory item in the taxpayer's inventory comprises 10 percent or more of total inventory value, such an inventory item must be placed in its own, separate index category. The index category selected must be the most detailed index category which includes that specific inventory item. In addition, any other inventory item that is included in such most detailed index category must also be included in such index category.

(*2*) If there are inventory items still remaining in the pool that have not been included in an index category, the taxpayer, beginning with the most detailed index categories for such remaining inventory items, must investigate successively less detailed index category levels and select the first index category that contains remaining inventory items which in the aggregate comprise 10 percent or more of total inventory value. The index category so selected must be the separate index category for the included inventory items. This procedure must be repeated either until all inventory items in the pool have been included in an index category, or until the remaining inventory items in the aggregate comprise less than 10 percent of total inventory value, or until it has been determined that no appropriate index category exists for the aggregate of such remaining inventory items.

(*3*) If there are inventory items remaining in the pool that comprise less than 10 percent of total inventory value, the index category to be selected for these inventory items must be the most detailed index category that includes such inventory items. If it has been determined that no appropriate index category exists for such remaining inventory items, such remaining inventory items must be combined in a miscellaneous index category created by the taxpayer.

In no event shall an index category be selected that is less detailed than either the 11 general categories of consumer goods described in Tables 3 and 5 of the *CPI Detailed Report* (see paragraph (e)(3)(iv) of this section), or the 15 general categories of producer goods described in Table 6 of the *Producer Prices and Price Indexes.* The determination of the appropriate index for an index category is accomplished as follows:

(*4*) Whenever an index category has been selected pursuant to paragraph (e)(3)(iii)(b)(*1*) of this section the appropriate index must be the published index for that index category.

(*5*) Whenever an index category has been selected pursuant to paragraph (e)(3)(iii)(B)(*2*) or (*3*) of this section, the appropriate index must be a weighted average of the published indexes of the index category items actually present in the taxpayer's inventory, excluding any index category items that have been placed in any other separate index category, weighted according to the weights used by BLS. Thus, if a taxpayer's inventory contains every inventory item that comprises the selected index category and none of these inventory items have been placed in any other separate index category, the appropriate index must be the published index for that index category. In the case of a miscellaneous index category created by the taxpayer, the appropriate index must be a weighted average of the published indexes for the index category items, weighted according to the weights used by BLS.

The use of BLS weights is limited only to the determination of the appropriate index for an index category. In computing the index for a pool, the taxpayer will weight the appropriate indexes for the separate index categories comprising the pool according to the taxpayer's actual inventory weights for such separate index categories. Whether the selection of the consumer or producer price indexes to be used to compute an inventory price index is appropriate, and the propriety of all computations incidental to the use of such consumer or producer price indexes, will be determined in connection with the examination of the taxpayer's income tax return. The selection of a consumer or producer price index for a specific good to compute an inventory price index under paragraph (e)(3) is a method of accounting. A taxpayer desiring to change the selection of such a consumer or producer price index must secure the consent of the Commissioner as provided in §1.446-1(e). In the case of such a change, any layers of inventory increments previously determined and the LIFO value of such increments shall be retained. Instead of using the earliest taxable year for which the taxpayer adopted the LIFO method for any items in the inventory pool, the year of such change shall be used as the base year in determining the LIFO value of the inventory pool for the year of change and later taxable years. The base year costs of layers of increments in the pool at the beginning of the year of change shall be restated in terms of new base year costs using the year of change as the new base year.

(C) *Other selection requirements.* Manufacturers, processors, wholesalers, jobbers, and distributors may select indexes from only *Producer Prices and Price Indexes.* Retailers may select indexes from either the *CPI Detailed Report* or *Producer Prices and Price Indexes*, but if equally appropriate indexes could be selected from either publication, a retailer using the retail inventory method must select the index from the *CPI Detailed Report* and a retailer not using the retail inventory method must select the index from *Producer Prices and Price Indexes.* If a retailer using the retail inventory method selects a price index from *Producer Prices and Price Indexes*, the selected index must be converted into a retail price index. If a retailer not using the retail inventory method selects an index from the *CPI Detailed Report*, the selected index must be converted into a cost price index. Manufacturers, processors, wholesalers, jobbers, and distributors, must convert selected indexes into cost price indexes. In the case of the *CPI Detailed Report*, indexes may be selected only from Table 3 (Consumer Price Index for All Urban Consumers: Food expenditure categories, U.S. city average) and Table 5 (Consumer Price Index for All Urban Consumers: Nonfood expenditure categories, U.S. city average). In the case of the *Producer Prices and Price Indexes*, indexes may be selected only from Table 6 (Producer prices and price indexes for commodity groupings and individual items), unless the taxpayer can demonstrate that the selection of an index from another *Producer Prices and Price Indexes* table would be more appropriate. In the case of a taxpayer using the retail inventory method, the selected index must be the index as of the last month of the taxpayer's taxable year. Taxpayers that do not use the retail inventory method must select indexes as of the month or months most appropriate to the taxpayer's method of determining the current-year cost of the inventory pool under paragraph (e)(2)(ii) of this section, or make a one-time binding election of an appropriate representative month during the taxable year. The election must be clearly set forth on Form 970 (see paragraph (e)(3)(v) of this section).

(iv) *Special rules for pools.* A retailer, wholesaler, jobber, or distributor computing an inventory price index in the manner provided by paragraph (e)(3) of this section may, at the option of the taxpayer, establish an inventory pool for any group of goods included within one of eleven general categories of consumer goods described in the *CPI Detailed Report.* The eleven categories are food and beverages, housing maintenance and repair commodities, fuels (other than gasoline), house furnishings and housekeeping supplies, apparel commodities, private transportation (including gasoline), medical care commodities, entertainment commodities, tobacco products, toilet goods and personal care appliances, and school books and supplies. Inventory pools that comprise less than 5 percent of inventory value may be combined to form a single miscellaneous inventory pool. If the resulting miscellaneous inventory pool itself comprises less than 5 percent of inventory value, such pool may be combined only with the largest inventory pool. See paragraphs (b), (c) and (d) of this section for additional rules relating to the establishment of pools. See also section 474 of the Code for rules relating to the use of a single pool by an eligible small business. Except as provided in paragraph (e)(3)(v) of this section, relating to the adoption or change of method of computing an inventory price index, the rules of paragraph (g)(1) and (2) of this section apply to a change in method of pooling.

(v) *Adoption or change of method.* The use of an inventory price index computed in the manner provided by paragraph (e)(3) of this section is considered a method of accounting. A taxpayer permitted to adopt or change to the dollar-value LIFO inventory method without first securing the consent of the Commissioner may also adopt the inventory price index computation method prescribed by paragraph (e)(3) incident to such adoption or change without first securing the consent of the Commissioner. In all other cases, a taxpayer may adopt or change to the inventory price index computation method prescribed by paragraph (e)(3) only after first securing the consent of the Commissioner as provided in §1.446-1(e). However, in the case of a taxpayer not using the inventory price index computation method prescribed by paragraph (e)(3), the taxpayer may adopt or change to such method for the taxpayer's first or second taxable year beginning after December 31, 1981, without requesting the Commissioner's consent to such adoption or change. In addition, in such a case the taxpayer is not required to request the Commissioner's consent to a change in method of pooling incident to such adoption or change if the taxpayer is changing to a method of pooling authorized by paragraph (e)(3)(iv). In this case the rules of §1.472-8(g) will apply. The inventory price index computation method provided by paragraph (e)(3) may be adopted and used only if the taxpayer indicates on a Form 970, or in such other manner as may be acceptable to the Commissioner, a listing of each inventory pool, the type of goods included in each pool, and the consumer or producer price index or indexes selected for each inventory pool. In the case of a taxpayer permitted to adopt or change to the inventory price index computation method without requesting the Commissioner's consent, the Form 970 shall be attached to the taxpayer's income tax return for the taxable year of such adoption or change. In other cases, the Form 970 shall be attached to a Form 3115 filed in accordance with §1.446-1(e). Taxpayers must maintain adequate books and records of the use and computation of the inventory price index method in order to satisfy the requirements of §1.472-2(h). Notwithstanding the rules in paragraph (e)(1) of this section, a taxpayer adopting or changing to the use of an inventory price index computed in the manner provided by paragraph (e)(3) is not required to demonstrate that the use of the double-extension method is impractical.

(vi) *Requirement incident to change.* In the case of a taxpayer using a method other than an inventory price index computed as prescribed by paragraph (e)(3) of this section to determine the LIFO value of a dollar-value inventory pool, any layers of inventory increments previously determined by such method and the LIFO value of such layers shall be retained if the taxpayer changes to the use of a price index computed as prescribed by paragraphs (e)(3). Instead of using the earliest taxable year for which the taxpayer adopted the LIFO method for any items in the pool, the year of such change shall be used as the base year in determining the LIFO value of the inventory pool for the year of change and later taxable years. The base year costs of layers of increments in the pool at the beginning of the year of change shall be restated in terms of new base year costs, using the year of change as the new base year. See paragraph (f)(2) of this section for rules relating to a change to the dollar-value method from another method of pricing LIFO inventories.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat 917; 26 U.S.C. 7805).

JAMES I. OWENS,
Acting Commissioner
of Internal Revenue.

Approved March 1, 1982,

JOHN E. CHAPOTON,
Assistant Secretary
of the Treasury.

Filed by the Office of the Federal Register on March 15, 1982, 8:45 a.m., and published in the issue of the Federal Register for March 16, 1982, 47 F.R. 11271)

Part III.—Adjustments

Section 481.—Adjustments Required by Changes in Method of Accounting

26 CFR 1.481-1: Adjustments in general.

Change of method of accounting for bad debts from the specific charge-off method to the reserve method. See Rev. Proc. 82-19, page 463.

26 CFR 1.481-1: Adjustments in general.

Advance consent is granted to change the method of accounting from deducting fully-vested vacation pay in the tax year it is paid to deducting it in the tax year in which it accrues. See Rev. Proc. 82-32, page 486.

Section 482.—Allocation of Income and Deductions Among Taxpayers

26 CFR 1.482-1: Allocation of income and deductions among taxpayers.
(Also Part III, Section 601.105.)

Allocation of income and deductions; U.S. subsidiary. A U.S. subsidiary whose taxable income has been increased for a tax year because of an allocation under section 482 of the Code may receive payment from its foreign parent corporation from which, or to which, the allocation of income or deductions was made, in an amount not in excess of the taxable income increase without further federal income tax consequences.

Rev. Rul. 82-80

A United States subsidiary, whose taxable income has been increased for a tax year because of an allocation under section 482 of the Internal Revenue Code, may receive payment from its foreign parent corporation from which, or to which, the allocation of income or deductions was made, in an amount not in excess of the taxable income increase without further federal income tax consequences. For procedures to be followed in applying this position and requirements that must be fulfilled to qualify for such treatment, see Rev. Proc. 65-17, 1965-1 C.B. 833.

Further, if Rev. Proc. 65-17 treatment is granted, the original transaction will be treated, for tax purposes, as if the correct amount, as determined under section 482 of the Code, was paid. For example, if a United States subsidiary pays more than arm's-length consideration for services performed by its foreign parent corporation, the parent corporation will not be considered to have received a dividend to the extent of the greater-than-arm's-length amount, and the withholding tax provisions of sections 881 and 1442 will not be applied.

---

26 CFR 1.482-1: Allocation of income and deductions among taxpayers.

Procedures are set forth for U.S. persons to obtain competent authority consideration where the U.S. or a foreign tax treaty country proposes or has made an allocation of income or deductions. See Rev. Proc. 82-29, page 481.

---

26 CFR 1.482-1: Allocation of income and deductions among taxpayers.

Whether the Commissioner will accept the timely filed amended returns of the DISC and its parent in which the DISC recomputes its income under a rule described in section 994(a) of the Code, other than that applied in its original return, to determine the maximum allowable commission, and in which the parent makes the correlative adjustments ? See Rev. Rul. 82-81, page 109.

---

26 CFR 1.482-2: Determination of taxable income in specific situations.

Allocation of income; restrictions on payments by foreign subsidiaries. Income may be allocated to a corporation under section 482 of the Code when payments under a technical assistance contract are restricted by the laws of a foreign country.

Rev. Rul. 82-45

ISSUE

May income be allocated to a corporation under section 482 of the Internal Revenue Code when payments by a related corporation are restricted by the laws of a foreign country?

FACTS

X is a domestic corporation. *Y*, a wholly-owned subsidiary of *X*, is organized under the laws of foreign country *Z*. *X* and *Y* entered into a technical assistance contract under which *Y* agreed to pay *X* for providing technical assistance with respect to the manufacture and processing of a product. Under the contract, *Y* is obligated to pay *X* at the rate of 5 percent of *Y*'s sales revenue from the product. The laws of country *Z* limit the payment of fees under the contract to 2 percent. For United States federal income tax purposes, *X* included in its gross income the 2 percent fee paid to it by *Y*, as limited by the laws of country *Z*.

LAW AND ANALYSIS

Section 482 of the Code provides authority to distribute, apportion, or allocate gross income, deductions, and credits or allowances between or among related organizations, trades, or businesses if it is necessary to prevent the evasion of taxes or clearly reflect the income of these entities.

In *Commissioner v. First Security Bank of Utah*, 405 U.S. 394 (1972), Ct. D. 1953, 1972-1 C.B. 135, the Supreme Court of the United States held that the Commissioner of Internal Revenue could not under section 482 of the Code properly allocate income as compensation for originating and processing credit life insurance policies to one of a controlled group of corporations when it was illegal under federal law for the corporation to receive that income.

First Security Bank of Utah concerned a proposed allocation under section 482 of the Code with respect to income the receipt of which was illegal under the laws of the United States. However, when the prohibition on the receipt of income is based not on the laws of the United States but rather on restrictions imposed by foreign governments, the decision in *First Security Bank of Utah* does not foreclose the Service from applying section 482 in order to clearly reflect income.

HOLDING

Income may be allocated to *X* under section 482 of the Code. The laws of country *Z* restricting payments under the technical assistance contracts do not limit the scope of the laws of the United States.

Section 483.—Interest on Certain Deferred Payments

26 CFR 1.483-2: Treatment as interest for purposes of Code; exceptions and limitations to application of section 483.

Imputed interest; zero interest mortgage loans. Where a house is purchased from a party who is in the trade or business of selling houses, with a portion of the purchase price represented by a note with no specified interest payable over 84 months, section 483 of the Code applies to the purchaser, who will be

entitled to a deduction under section 163 for the imputed interest payments to the seller. Where the house is purchased from a party not in the trade or business of selling houses, section 483 applies to both the purchaser and seller. In both situations, the purchaser's basis in the house must be reduced by the amount of interest allocated.

Rev. Rul. 82-124

ISSUE

Is interest imputed to the purchaser and seller of a house under the factual situations described below?

FACTS

Situation 1. In October 1981, *A*, an individual taxpayer, entered into a contract with *B*, an individual, to purchase a house for 75*x* dollars. *B* is a dealer in the business of selling houses. *A* made a down payment of 26*x* dollars and signed a note given to *B* to pay off the balance through 84 fixed monthly payments to *B*. Neither the contract of sale nor the note specified any interest payable by *A* to *B*. *B*'s adjusted basis in the house is 60*x* dollars.

Situation 2. The facts are the same as in *Situation 1* except that *B* is not a dealer in the trade or business of building or selling houses nor is *B* a real estate developer. *B* owned the house for more than 1 year.

In both situations, *A* and *B* are not related parties within the meaning of section 483(g) of the Code.

LAW AND ANALYSIS

Section 483 of the Code provides, in general, that deferred payment or installment contracts for sale or exchange of property for more than $3,000 for which some or all of the payments are due more than one year after sale are deemed to include interest at a rate fixed by the regulations if no interest or unreasonably low interest is specified in the contract.

Section 483(f)(3) of the Code provides an exception to this general rule. It states that, in the case of the seller, the tax treatment of any amounts received on account of the sale or exchange of property shall be made without regard to section 483 if all of the gain, if any, on such sale or exchange would be considered as ordinary income.

Section 1.483-2(b)(3)(i) of the Income Tax Regulations provides, in part, that, in the case of the seller, the determination of the tax treatment of any amounts received on account of the sale or exchange of property shall be made without regard to section 483 if no part of any gain on such sale or exchange would (if the property were sold at a gain) be considered as gain from the sale or exchange of a capital asset or property described in section 1231 (relating to property used in the trade or business and involuntary conversions).

Section 1.483-2(b)(3)(ii) of the regulations provides that the purchaser under a contract under which there are payments to which section 483 of the Code applies will determine the amount of any interest deduction under section 483, even though that section does not apply to the seller because of the provisions of section 1.483-2(b)(3)(i) of the regulations.

In *Situation 1*, since *B* is a dealer, *B* will recognize a total of 15x dollars of ordinary income as a result of the sale to *A*. This is because the house was not a capital asset in *B*'s hands as it was held for sale to *B*'s customers. See section 1221(1) of the Code. Therefore, in *Situation 1*, interest will not be imputed to *B* under section 483 of the Code because *B*'s gain on the sale of the house was ordinary income in any event. However, section 1.483-2(b)(3)(ii) of the regulations provides that the purchaser under a contract under which there are payments to which section 483 applies looks to section 483 to determine the amount of any interest deductions, notwithstanding the fact that section 483 does not apply to the seller because the seller had ordinary income in any event. Thus, in *Situation 1*, section 483 will apply to *A* and *A* will be able to deduct a portion of each payment to *B* as interest under section 163 of the Code, as an itemized deduction, provided *A*'s itemized deductions are in excess of *A*'s zero bracket amount. The amount of the interest deduction must be computed in accordance with regulation section 1.483-1(g)(2), Table VII. *A*'s basis for the house must also be reduced by the total amount allocated to interest during the term of the note. See section 1012 of the Code and section 1.483-2(a)(1)(i) of the regulations.

In *Situation 2*, since the house is a capital asset, as defined in section 1221 of the Code, in *B*'s hands, *B* will recognize capital gain and report the gain in accordance with section 453 upon the sale of the house to *A*. The exception in section 483(f)(3) does not apply to *B* because the gain on the sale of the house is not ordinary income. Therefore, a portion of each payment from *A* to *B* will be treated as containing elements of principal and interest under the general rule of section 483. Accordingly, in *Situation 2*, *B* must include as ordinary (interest) income a portion of each payment received from *A*, and *B*'s amount realized will be some amount less than 75*x* dollars and *B*'s capital gain will be some amount less than 15*x* dollars. *A* must reduce the basis of the house and is entitled to deduct the interest portion of each payment as described above in *Situation 1*. The amount of the interest income to *B* and interest deduction to *A* must be computed in accordance with regulation section 1.483-1(g)(2), Table VII.

HOLDINGS

In *Situation 1* and *Situation 2*, *A* is entitled to deduct a portion of each payment to *B* as interest under section 163 of the Code as an itemized deduction provided *A*'s itemized deductions are in excess of *A*'s zero bracket amount. In both situations, *A*'s basis for the house must also be reduced by the total amount allocated to interest during the term of the note.

In accordance with section 483 of the Code, *B* will not have any portion of the payments received imputed as interest income in *Situation 1*, but, in *Situation 2*, *B* will have a portion of each payment imputed as interest income.

Subpart F.—Exempt Organizations
Part I.—General Rule

Section 501.—Exemption from Tax on Corporations, Certain Trusts, etc.

26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.

A list is provided identifying which states have statutes providing for the distribution of assets upon dissolution of nonprofit trusts, corporations, and unincorporated associations, which satisfy the provisions of section 1.501(c)(3)-1(b)(4) of the Income Tax Regulations. See Rev. Proc. 82-2, page 367.

---

26 CFR 1.501(c)(6)-1: Business leagues, chambers of commerce, real estate boards, and boards of trade.

Whether increased amounts paid to a trade association by its members are deductible under section 162(a) of the Code when the increased charges are allocated to a special fund to be used for the benefit of the association's members. See Rev. Rul. 82-15, page 29.

Subchapter G.—Corporations Used to Avoid Income Tax on Shareholders
Part II—Personal Holding Companies

Section 544.—Rules for Determining Stock Ownership

26 CFR 1.544-3: Constructive ownership by reason of family and partnership ownership.

Will the taxpayer lose its status as a regulated investment company, because it will become a personal holding company by reason of the partnership attribution rules? See Rev. Rul. 82-107, page 103.

Subchapter I.—Natural Resources
Part I.—Deductions

Section 611.—Allowance of Deduction for Depletion

26 CFR 1.611-1: Allowance of deduction for depletion.

Whether a lessee is required to exclude only a portion of a bonus paid on acquisition of an oil and gas property where only a portion of the oil and gas produced and sold is subject to the percentage depletion allowance. See Rev. Rul. 82-3, page 93.

---

26 CFR 1.611-1: Allowance of deduction for depletion.

Whether carbon dioxide (CO_2) is eligible for percentage depletion under section 613 or 613A of the Code. See Rev. Rul. 82-17, page 95.

Section 612.—Basis for Cost Depletion

26 CFR 1.612-3: Depletion; treatment of bonus and advanced royalty.

Whether a lessee is required to exclude only a portion of a bonus paid on acquisition of an oil and gas property where only a portion of the oil and gas produced and sold is subject to the percentage depletion allowance. See Rev. Rul. 82-3, page 368.

---

26 CFR 1.612-4: Charges to capital and to expense in case of oil and gas wells.

Whether a taxpayer is entitled to a charitable contribution deduction for the contribution of well cuttings, scout tickets, and electrical well logs. See Rev. Rul. 82-9, page 39.

---

26 CFR 1.612-4: Charges to capital and to expense in case of oil and gas wells.

Whether the costs incurred in drilling carbon dioxide (CO_2) source wells are subject to the option to expense as intangible drilling and development cost (IDC). See Rev. Rul. 82-17, page 95.

---

26 CFR 1.612-5: Charges to capital and to expenses in case of geothermal wells.

T.D. 7806

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Intangible drilling and development costs in the case of geothermal deposits

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to the option to capitalize or deduct intangible drilling and development costs in the case of wells drilled for any geothermal deposit. The regulations are prescribed under a change to the applicable tax law made by the Energy Tax Act of 1978 [Pub. L. 95-618, 1978-3 C.B. (Vol. 2) 1]. The regulations provide the public with the guidance needed to comply with the applicable part of this Act.

EFFECTIVE DATE: The regulations are effective for taxable year endings on or after October 1, 1978, with respect to geothermal wells commenced on or after that date.

FOR FURTHER INFORMATION CONTACT: Walter H. Woo of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3297).

SUPPLEMENTARY INFORMATION:

BACKGROUND AND EXPLANATION OF PROVISIONS

On January 30, 1980, the FEDERAL REGISTER published Temporary Income Tax Regulations under the Energy Tax Act of 1978 [T.D. 7669, 1980-1 C.B. 131] (26 CFR Part 5a) and proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 612 of the Internal Revenue Code of 1954 to implement section 402(a) and (e) of the Energy Tax Act of 1978 (92 Stat. 3174). No public hearing was requested or held. This Treasury decision adopts the amendments as proposed and deletes the temporary regulations.

These regulations grant the option to capitalize or deduct intangible drilling and development costs in the case of wells drilled for any geothermal deposit to the same extent and in the same manner as such expenses are deductible in the case of oil and gas wells.

The only comment received requested that the term "geothermal deposit" be defined to include ground water aquifers. The regulations do not contain a definition of geothermal deposit, because the definition of that term is the subject of a separate regulation project.

The effectiveness of these regulations will be evaluated on the basis of comments and information received from offices within the Treasury Department and Internal Revenue Service, other governmental agencies, and the public. Under the regulations, no additional reporting or filing require-

READEX FICHE

ments have been imposed on taxpayers.

DRAFTING INFORMATION

The principal author of these regulations is David B. Cubeta of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, the proposed amendments to 26 CFR Part 1, as set forth in the notice of proposed rulemaking published in the FEDERAL REGISTER on January 30, 1980 (45 F.R. 6778), are hereby adopted without change and 26 CFR Part 5a is hereby deleted.

Paragraph 1. Following §1.612-4, a new §1.612-5 is added to read as follows:

§1.612-5 Charges to capital and to expense in case of geothermal wells.

(a) *Option with respect to intangible drilling and development costs.* In accordance with the provisions of section 263(c), intangible drilling and development costs incurred by an operator (one who holds a working or operating interest in any tract or parcel of land either as a fee owner or under a lease or any other form of contract granting working or operating rights) in the development of a geothermal deposit (as defined in section 613(e)(3) and the regulations thereunder) may at the operator's option be chargeable to capital or to expense. This option applies to all expenditures made by an operator for wages, fuel, repairs, hauling, supplies, etc., incident to and necessary for the drilling of wells and the preparation of wells for the production of geothermal steam or hot water. Such expenditures have for convenience been termed intangible drilling and development costs. They include the cost to operators of any drilling or development work (excluding amounts payable only out of production or gross or net proceeds from production, if such amounts are depletable income to the recipient, and amounts properly allocable to cost of depreciable property) done for them by contractors under any form of contract, including turnkey contracts. Examples of items to which this option applies are all amounts paid for labor, fuel, repairs, hauling, and supplies, or any of them, which are used—

(1) In the drilling, shooting, and cleaning of wells,

(2) In such clearing of ground, draining, road making, surveying, and geological work as are necessary in preparation for the drilling of wells, and

(3) In the construction of such derricks, tanks, pipelines, and other physical structures as are necessary for the drilling of wells and the preparation of wells for the production of geothermal steam or hot water.

In general, this option applies only to expenditures for those drilling and developing items which in themselves do not have a salvage value. For the purpose of this option, labor, fuel, repairs, hauling, supplies, etc. are not considered as having a salvage value, even though used in connection with the installation of physical property which has a salvage value. Included in this option are all costs of drilling and development undertaken (directly or through a contract) by an operator of a geothermal property whether incurred by the operator prior or subsequent to the formal grant or assignment of operating rights (a leasehold interest, or other form of operating rights, or working interest); except that in any case where any drilling or development project is undertaken for the grant or assignment of a fraction of the operating rights, only that part of the costs thereof which is attributable to such fractional interest is within this option. In the excepted cases, costs of the project undertaken, including depreciable equipment furnished, to the extent allocable to fractions of the operating rights held by others, must be capitalized as the depletable capital cost of the fractional interest thus acquired.

(b) *Recovery of optional items, if capitalized.* (1) Items recoverable through depletion: If the taxpayer charges such expenditures as fall within the option to capital account, the amounts so capitalized and not deducted as a loss are recoverable through depletion insofar as they are not represented by physical property. For the purposes of this section the expenditures for clearing ground, draining, road making, surveying, geological work, excavation, grading, and the drilling, shooting, and cleaning of wells, are considered not to be represented by physical property, and when charged to capital account are recoverable through depletion.

(2) Items recoverable through depreciation: If the taxpayer charges such expenditures as fall within the option to capital account, the amounts so capitalized and not deducted as a loss are recoverable through depreciation insofar as they are represented by physical property. Such expenditures are amounts paid for wages, fuel, repairs, hauling, supplies, etc. used in the installation of casing and equipment and in the construction on the property of derricks and other physical structures.

(3) In the case of capitalized intangible drilling and development costs incurred under a contract, such costs shall be allocated between the foregoing classes of items specified in subparagraphs (1) and (2) for the purpose of determining the depletion and depreciation allowances.

(4) Option with respect to cost of nonproductive wells: If the operator has elected to capitalize intangible drilling and development costs, then an additional option is accorded with respect to intangible drilling and development costs incurred in drilling a nonproductive well. Such costs incurred in drilling a nonproductive well may be deducted by the taxpayer as an ordinary loss provided a proper election is made in the taxpayer's original or amended return for the first taxable year ending on or after October 1, 1978, in which such a nonproductive well is completed. The taxpayer must make a clear statement of election under this option in the return or amended return. The election may be revoked by the filing of an amended re-

turn that does not contain such a statement. The absence of a clear indication in such return of an election to deduct as oridinary losses intangible drilling and development costs of nonproductive wells shall be deemed to be an election to recover such costs through depletion to the extent that they are not represented by physical property, and through depreciation to the extent that they are represented by physical property. Upon the expiration of the time for filing a claim for credit or refund of any overpayment of tax imposed by chapter 1 of the Code with respect to the first taxable year ending on or after October 1, 1978 in which a nonproductive well is completed, the taxpayer is bound for all subsequent years by his exercise of the option to deduct intangible drilling and development costs of nonproductive wells as an ordinary loss or his deemed election to recover such costs through depletion or depreciation.

(c) *Nonoptional items distinguished.* (1) Capital items: The option with respect to intangible drilling and development costs does not apply to expenditures by which the taxpayer acquires tangible property ordinarily considered as having a salvage value. Examples of such items are the costs of the actual materials in those structures which are constructed in the wells and on the property, and the cost of drilling tools, pipe, casing, tubing, tanks, engines, boilers, machines, etc. The option does not apply to any expenditure for wages, fuel, repairs, hauling, supplies, etc., in connection with equipment, facilities, or structures, not incident to or necessary for the drilling of wells, such as structures for treating geothermal steam or hot water. These are capital items and are recoverable through depreciation.

(2) Expense items: Expenditures which must be charged off as expense, regardless of the option provided by this section, are those for labor, fuel, repairs, hauling, supplies, etc., in connection with the operation of the wells and of other facilities on the property for the production of geothermal steam or hot water.

(d) *Manner of making election.* The option granted in paragraph (a) of this section to charge intangible drilling and development costs to expense may be exercised by claiming intangible drilling and development costs as a deduction on the taxpayer's original or amended return for the first taxable year ending on or after October 1, 1978, in which the taxpayer pays or incurs such costs with respect to a geothermal well commenced on or after that date. No formal statement is necessary. The exercise of the option may be revoked by the filing of an amended return that does not claim such a deduction. If the taxpayer fails to deduct such costs as expenses in any such return, he shall be deemed to have elected to recover such costs through depletion to the extent that they are not represented by physical property, and through depreciation to the extent that they are represented by physical property. Upon the expiration of the time for filing a claim for credit or refund of any overpayment of tax imposed by chapter 1 of the Code with respect to the first taxable year ending on or after October 1, 1978, in which the taxpayer pays or incurs intangible drilling and developmental costs with respect to a geothermal well commenced on or after that date, the taxpayer is bound by his exercise of the option to charge such costs to expense or his deemed election to recover such costs through depletion or depreciation for that year and for all subsequent years.

(e) *Effective date.* The option granted by paragraph (a) of this section is available only for taxable years ending on or after October 1, 1978, with respect to geothermal wells commenced on or after that date.

This Treasury decision is issued under the authority contained in sections 263 and 7805 of the Internal Revenue Code of 1954 (92 Stat. 3201, 26 U.S.C. 362; 68A Stat. 917, 26 U.S.C. 7805).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved January 13, 1982.

JOHN E. CHAPOTON,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 27, 1982, 8:45 a.m., and published in the issue of the Federal Register for January 28, 1982, 47 F.R. 4060)

Section 613.—Percentage Depletion

26 CFR 1.613-2: Percentage depletion rates. (Also Sections 611, 612; 1.611-1, 1.612-3.)

Depletion; gross income from property; exclusion of portion of bonus; crude oil not subject to percentage depletion. From a single oil and gas property the taxpayer produces natural gas that is subject to percentage depletion under section 613A of the Code and crude oil that is not subject to percentage depletion. The method is shown for determining the allocable part of the bonus that must be excluded in determining the taxpayer's "gross income from the property" under section 613A.

Rev. Rul. 82-3

ISSUE

How is the bonus exclusion rule, which is provided by section 1.613-2(c)(5)(ii) of the Income Tax Regulations, applied in computing the depletion deduction for a property on which only a portion of the oil and gas produced and sold is subject to the percentage depletion allowance?

FACTS

Corporation *X*, a taxpayer that files returns on a calendar year basis, held a producing oil and gas lease, *L*, that was acquired before 1975 by payment of a $50,000 lease bonus. In 1975, production began and *X*'s share of the oil and gas produced from the property was 39,600 barrels of oil and 540,000 thousand cubic feet of gas for a total gross income at the wellhead of $1,080,000 for oil and $540,000 for gas. Production in 1975 was 1/15th of the estimated recoverable reserves. All natural gas sold from the property was gas sold under a fixed contract within the meaning of section 613A(b)(1) of the Internal Revenue Code.

X, an integrated producer, is not entitled to percentage depletion on crude oil under sections 613 and 613A of the Code.

LAW AND ANALYSIS

Section 611(a) of the Code provides for a reasonable depletion allowance for oil and gas wells.

Section 1.611-1 of the regulations provides that the allowance for depletion will be computed upon either the adjusted depletion basis of the property (cost depletion under section 612 of the Code) or on a percentage of gross income from the property (under section 613 of the Code), whichever results in the greater depletion allowance in respect of the property for any tax year.

Section 613(a) of the Code provides that the allowance for depletion is a percentage (as specified in section 613(b)) of the gross income from the property excluding any rents or royalties paid or incurred by the taxpayer in respect of the property. This allowance is not to exceed 50 percent of the taxpayer's taxable income from the property (computed without allowance for depletion).

Section 613(A)(a) of the Codes provides that, in the case of oil and gas produced after December 31, 1974, and to which gross income from the property is attributable after such year, the depletion allowance with respect to any oil or gas property will be computed without regard to section 613.

Section 613(A)(b) of the Code provides an exemption from the general rule stated in section 613A(a) with respect to certain domestic gas wells.

Section 613A(b)(1) provides that the depletion allowance under section 611 will be computed in accordance with section 613 with respect to regulated natural gas and natural gas sold under a fixed contract, and 22 percent shall be deemed to be specified in section 613(b) for purposes of subsection (a) of that section.

Section 1.613-2(c)(2) of the regulations provides that, when two or more minerals are produced from the same mineral property, each mineral entitled to a different percentage depletion rate under section 613(b) or any of which is entitled to cost depletion only, the percentage depletion allowance is the sum of the results obtained by applying the percentage applicable to each mineral (zero, if not entitled to percentage depletion) to the "gross income from the property" attributable to that mineral.

Section 1.613-2(c)(5)(ii) of the regulations provides that, if bonus payments have been paid in respect of the property in any tax year or any prior tax years, the payor must exclude in determining gross income from the property an amount equal to that part of the payment that is allocable to the product sold (or otherwise giving rise to gross income) for the taxable year.

The total gross income from the property (GIFP) is the sum of the sales proceeds for the natural gas and the crude oil less one-fifteenth of the bonus, which is the portion of the bonus allocable to production during the tax year 1975. Thus,

$$\text{Total GIFP} = \$1{,}620{,}000 - \frac{1}{15}(\$50{,}000)$$

$$= \$1{,}616{,}667$$

X, an integrated producer, is entitled to percentage depletion on regulated natural gas and natural gas under a fixed contract but is not entitled to percentage depletion on oil and other natural gas. Here, all production of natural gas for lease *L* is sold under a fixed contract. To compute *X*'s percentage depletion allowance on production from lease *L*, the portion of GIFP that is subject to percentage depletion must be determined.

The GIFP allocable to the natural gas, which is subject to percentage depletion, bears the same proportion to the total GIFP (excluding the bonus) as the total proceeds (without bonus exclusion) from sale of *X*'s share of the natural gas sold under a fixed contract bears to the total proceeds (without bonus exclusion) from the sale of *X*'s share of all natural gas and oil. Thus, for natural gas,

$$\text{GIFP (natural gas)} = \text{GIFP (excluding bonus)} \times \frac{\text{Total sales of natural gas (w/o bonus exclusion)}}{\text{Total sales of all minerals (w/o bonus exclusion)}}$$

$$\text{GIFP (natural gas)} = \$1{,}616{,}667 \times \frac{\$540{,}000}{\$1{,}620{,}000}$$

$$= \$538{,}889$$

$$\text{Percentage depl. allowable} = \text{GIFP (natural gas)} \times \text{depletion rate}$$

$$\text{Percentage depl. allowable} = \$538{,}889 \times .22 = \$118{,}556$$

Similarily, for the oil,

$$\text{GIFP (oil)} = \$1{,}616{,}667 \times \frac{\$1{,}080{,}000}{1{,}620{,}000}$$

$$= \$1{,}077{,}778$$

$$\text{Percentage depl. allowable} = \$1{,}077{,}778 \times 0.0$$

$$= \underline{0}$$

X is entitled to a percentage depletion allowance of $118,556 if this amount is greater than the cost depletion deduction and less than or equal to 50 percent of the taxable income from the property.

HOLDING

If a bonus has been paid in respect of a property, a portion of the bonus is excluded in computing gross income from the property derived from any sale of oil and gas produced from the property. The gross income from the property so computed is allocated between the minerals sold from the property that are subject to percentage depletion and those that are not subject to percentage depletion in proportion to the gross income derived from each type of mineral computed without the bonus exclusion.

---

26 CFR 1.613-2: Percentage depletion rates. (Also Sections 263, 611, 612, 613A; 1.263(c)-1, 1.611-1, 1.612-4, 1.613A-1.)

Depletion; carbon dioxide (CO_2) produced from a well; treatment of costs of drilling CO_2 source wells. Carbon dioxide (CO_2) produced from a well is subject to percentage depletion at the rate of 14 percent as a mineral described in the term "all other minerals" in section 613(b)(7) of the Code. The costs of drilling CO_2 source wells to supply CO_2 to be injected in certain oil fields are not subject to the option to expense intangible drilling and development costs.

Rev. Rul. 82-17

ISSUES

1. Is carbon dioxide (CO_2) eligible for percentage depletion under section 613 or 613A of the Internal Revenue Code?

2. Are the costs incurred in drilling CO_2 source wells subject to the option to treat intangible drilling and development costs (IDC) as expenses as defined in section 1.612-4 of the Income Tax Regulations?

FACTS

X is prepared to initiate a tertiary project in which CO_2 will be used as one of the drive mechanisms for the recovery of tertiary oil. *X* proposes to drill several CO_2 wells to supply the needed CO_2 to be injected in certain oil fields. This CO_2 will be moved by pipeline from the CO_2 supply field to the oil and gas field and then injected into the tertiary recovery project injection wells.

At usually encountered temperatures and atmospheric pressure, CO_2 is a gas.

LAW AND ANALYSIS

Section 611(a) of the Code provides a reasonable depletion allowance in computing taxable income for mines, oil and gas wells, and other natural deposits.

Section 612 of the Code provides that cost depletion will be allowed on the adjusted basis of the property.

Section 613(a) of the Code provides that in the case of mines, wells, and other natural deposits listed in subsection (b), the allowance for depletion will be the percentage, listed in subsection (b), of the gross income from the property excluding rents and royalties paid by the taxpayer in regard to the property. The depletion allowance may not exceed 50 percent of the taxpayer's taxable income from the property, computed without the allowance for depletion. The greater of cost or percentage depletion will be used in regard to the property.

Sections 613(b)(1) through (6) of the Code provide certain percentage depletion rates for wells, mines, and other natural deposits. Section 613(b)(7) provides a certain percentage depletion rate for all other minerals but specifically excludes oil and gas wells from the term "all other minerals." Section 613(d) denies percentage depletion in the case of oil and gas wells except as provided in section 613A.

Section 613A(a) of the Code provides that the allowance for depletion under section 611 with respect to any oil or gas well will be computed without regard to section 613 except as otherwise provided in this section. Section 613A(b) provides for the allowance for depletion under section 611 to be computed in accordance with section 613 for both regulated natural gas and natural gas sold under a fixed contract. Section 613A(c)(1) provides that independent producers and royalty owners are entitled to percentage depletion allowances on so much of a taxpayer's average daily production of domestic crude oil or natural gas as does not exceed the taxpayer's depletable crude oil quantity or natural gas quantity.

Section 263(a) of the Code denies a deduction for new buildings, permanent improvements or betterments made to increase the value of any property or estate. Section 263(c) permits the deduction of IDC for oil and gas wells under regulations prescribed by the Secretary.

Section 1.612-4(a) of the regulations provides that IDC incurred by an operator (one who holds a working or operating interest in any tract or parcel of land either as a fee owner or under a lease or any other form of contract granting working or operating rights) in the development of oil and gas properties may at the operator's option be expensed, provided a timely election is made. The option applies to expenditures made by the operator for wages, fuel, repairs, hauling, supplies, and the like incident to the drilling of the wells and the preparation of the wells for the production of oil and gas.

Although in the physical sense CO_2 is a gas, it is not the gas referred to in the term "oil and gas wells" in sections 263(c), 611, 613 and 613A of the Code. The gas referred to in these sections is hydrocarbon gas. The CO_2 is an exhaustible natural deposit but is not specifically referred to in any of the categories named in paragraphs 613(b)(1) through (6). Thus, it falls in the category of all other mineral described in section 613(b)(7) and is eligible for percentage depletion at the rate of 14 percent. Section 613A does not deny percentage depletion for CO_2.

The CO_2 source wells are not drilled for the purpose of producing oil or (hydrocarbon) gas from the wells drilled; therefore, costs of drilling the wells are not subject to treatment as IDC.

HOLDINGS

1. CO_2 produced from a well is subject to percentage depletion at the rate of 14 percent as a mineral described in the term "all other minerals" in section 613(b)(7) of the Code.

2. The costs of drilling CO_2 source wells are not subject to the option to expense as IDC.

Section 613A.—Limitations on Percentage Depletion in Case of Oil and Gas Wells

26 CFR 1.613A-1; Post-1974 limitations on percentage depletion in case of oil and gas wells; general rule.

Whether carbon dioxide (CO_2) is eligible for percentage depletion under section 613A of the Code. See Rev. Rul. 82-17, page 95.

Subchapter J.—Estates, Trusts, Beneficiaries, and Decedents
Part I.—Estates, Trusts, and Beneficiaries
Subpart A.—General Rules for Taxation of Estates and Trusts

Section 642.—Special Rules for Credits and Deductions

26 CFR 1.642(c)-5: Definition of pooled income fund.

Pooled income funds; sample provisions for governing instruments. Sample provisions for inclusion in a Declaration of Trust and an Instrument of Transfer that may be used to satisfy section 642(c)(5) of the Code are set forth to serve as a guide in developing governing instruments for pooled income funds. Rev. Rul. 72-196 amplified, clarified, and superseded.

Rev. Rul. 82-38

SECTION 1. PURPOSE

The purpose of this revenue ruling is to amplify and clarify the provisions in Rev. Rul. 72-196, 1972-1 C.B. 194. This revenue ruling sets forth illustrative sample provisions for inclusion in a Declaration of Trust and an Instrument of Transfer that may be used to satisfy the requirements of section 642(c)(5) of the Internal Revenue Code with respect to a pooled income fund. Except where the context indicates otherwise, the sample provisions set forth in sections 3 through 10 are based on the following assumptions: (1) Y Pooled Income Fund is established by the Declaration of Trust, (2) property is transferred to the fund pursuant to an Instrument of Transfer in which an income interest is retained and created for the lives of the donor and the donor's spouse and an irrevocable remainder interest in the property is contributed to the Y Public Charity, and (3) the donor has retained the power to terminate by will the income interest for the life of the donor's spouse.

SEC. 2. BACKGROUND AND DEFINITIONS

.01 Section 1.642(c)-5(b) of the Income Tax Regulations sets forth specific requirements for qualification of a pooled income fund.

.02 By virtue of section 4947(a)(2) of the Code, a pooled income fund is subject to the governing instrument requirements of section 508(e). For sample provisions of governing instruments meeting the requirements of section 508(e), see Rev. Rul. 70-270, 1970-1 C.B. 135, but note the exception contained in section 4947(b)(3)(B) with respect to a pooled income fund. See also Rev. Rul. 75-38, 1975-1 C.B. 161, for a list of states that have enacted legislation pursuant to which the governing instruments of private foundations under the jurisdiction of such states are considered to have been amended as required by section 508(e).

.03 Section 1.642(c)-5(a)(5)(iii) of the regulations provides that the term "governing instrument" means either the governing plan (referred to in this revenue ruling as the Declaration of Trust) under which the pooled income fund is established and administered or the Instrument of Transfer, as the context requires.

.04 Section 1.642(c)-5(a)(5)(iv) of the regulations provides that the term "public charity" means an organization described in clauses (i) to (vi) of section 170(b)(1)(A) of the Code. If an organization is described in clauses (i) to (vi) of section 170(b)(1)(A) and is also described in clause (viii) of that section, it will be treated as a public charity.

SEC. 3. CONTRIBUTION OF REMAINDER INTEREST TO PUBLIC CHARITY

.01 Each donor must transfer property to a pooled income fund and contribute an irrevocable remainder interest in that property to or for the use of a public charity. A contingent remainder interest is not treated as an irrevocable remainder interest. (See section 1.642(c)-5(b)(1) of the regulations.)

.02 The following sample provision for a Declaration of Trust satisfies the requirement described in Sec. 3.01:

> Each donor transferring property to Y Pooled Income Fund shall contribute an irrevocable remainder interest in that property to or for the use of Y Public Charity.

.03 The following sample provision for an Instrument of Transfer satisfies the requirement described in Sec. 3.01:

> Upon the death of either the Donor or the Donor's spouse, whichever is later, or upon the death of the Donor if the Donor exercises the power to terminate the life income interest upon the Donor's death, the Trustee of Y Pooled Income Fund shall sever from the Fund an amount equal to the value of the remainder interest in the property upon which the income interest is based and transfer it to Y Public Charity.

SEC. 4. CREATION OF LIFE INCOME INTEREST

.01 Each donor must retain for the donor's life an income interest in the property transferred to the pooled income fund, or create an income interest in the property for the life of one or more beneficiaries, each of whom must be living at the time of the transfer of the property to the fund. The public charity to or for the use of which the remainder interest is contributed may also be designated as one of the beneficiaries of an income interest. The donor may retain the power exercisable only by will to revoke or terminate the income interest of any designated beneficiary other than the public charity. The governing instrument must specify at the time of the transfer the particular beneficiary or beneficiaries to whom the income is payable and the share of income distributable to each person so specified. No charitable contributions deduction is allowed to the donor for the value of an income interest to which the public charity is a beneficiary or for the amount of any income paid by the fund to the public charity. (See section 1.642(c)-5(b)(2) of the regulations.)

.02 The following sample provision for a Declaration of Trust satisfies the requirements described in Sec. 4.01:

> Each donor transferring property to Y Pooled Income Fund shall retain for the donor's life an income interest in the property transferred, or create an income interest in the property for the life of one or more named beneficiaries, each of

> whom must be living at the time of the transfer of property to the Fund by the donor. Every income interest retained or created in property transferred to the Fund shall be represented by units of participation in the Fund. If more than one beneficiary of the income interest is named, the named beneficiaries may enjoy their shares of income concurrently, consecutively, or both concurrently and consecutively. Y Public Charity may also be designated as one of the beneficiaries of the income interest. The donor need not retain or create a life interest in all the income from the property transferred to the Fund provided any income not payable to an income beneficiary under the terms of the Instrument of Transfer is contributed to, and within the taxable year of the Fund in which it is received is paid to, the Y Public Charity.

.03 If a donor created an income interest to be enjoyed consecutively only, the following sample provision for an Instrument of Transfer will satisfy the requirements described in Sec. 4.01:

> The Donor retains for the Donor's life an income interest in the property transferred to Y Pooled Income Fund. In the event that Donor's spouse (insert name) survives the Donor, there is hereby created an income interest in such property to commence on the Donor's death for the rest of the spouse's life. However, the Donor reserves the right to appoint and direct by will that the life income interest created for the Donor's spouse in such property shall terminate upon the Donor's death.

.04 If a donor creates an income interest to be enjoyed concurrently and consecutively, the following sample provision for an Instrument of Transfer will satisfy the requirements described in Sec. 4.01:

> The Donor retains and creates for the Donor and the Donor's spouse (insert name) during their joint lives an income interest in the property transferred to Y Pooled Income Fund. During their joint lives the Donor's share of income will be ____ percent and the spouse's share will be ____ percent. Upon the death of the first to die, the survivor shall receive the entire income interest for the rest of his or her life. However, the Donor reserves the right to appoint and direct by will that the life income interest created for the Donor's spouse in the property shall terminate upon the Donor's death.

.05 If two donors transfer jointly owned property (whether their interests are equal or unequal) to a pooled income fund and if either or both donors retain the power, exercisable only by will, to revoke or terminate the income interest of any designated beneficiary, then each donor's power may extend only over that donor's own interest in the property.

.06 If *A* and *B* are donors who transfer jointly owned property and retain an income interest for themselves, the following sample provision for an Instrument of Transfer satisfies the requirements described in Secs. 4.01 and 4.05:

> The Donors retain for their joint lives an income interest in the property transferred to Y Pooled Income Fund (Insert Donor *A*'s name) share of income will be ____ percent and (insert Donor *B*'s name) share of income will be ____ percent. Upon the death of the first to die, the survivor shall receive the entire income interest for the rest of the survivor's life. However, each Donor retains the power, exercisable only by will, to revoke or terminate the interest of the survivor created in the deceased Donor's interest in the property.

SEC. 5. COMMINGLING OF PROPERTY REQUIRED

.01 The property transferred to a pooled income fund by a donor must be commingled with, and invested or reinvested with, other property transferred to the fund by other donors satisfying the requirements described in Secs. 3.01 and 4.01. The governing instrument must contain a provision requiring compliance with this requirement on commingling and investing or reinvesting of property. A pooled income fund must not include property transferred under arrangements other than those specified in section 642(c)(5) of the Code and section 1.642(c)-5(b)(3) of the regulations. A pooled income fund shall not be disqualified if any portion of its properties is invested or reinvested jointly with other properties, not a part of the pooled income fund, that are held by, or for the use of, the public charity that maintains the fund. (See section 1.642(c)-5(b)(3) of the regulations.)

.02 The following sample provision for a Declaration of Trust satisfies the requirement described in Sec. 5.01:

> The property transferred to Y Pooled Income Fund by each donor must be commingled with, and invested or reinvested with, other property transferred to the Fund by other donors satisfying the requirements of this instrument and of section 642(c)(5)(A) of the Code or corresponding provision of any subsequent federal tax law. The Fund shall not include property transferred under arrangements other than those specified in this instrument and section 642(c)(5) or corresponding provision of any subsequent federal tax law. All or any portion of the Fund may, however, be invested or reinvested jointly with other properties, not a part of the Fund, that are held by, or for the use of, Y Public Charity. When joint investment or reinvestment occurs, detailed accounting records shall be maintained by the Trustee of the Fund specifically identifying the portion of the total fund that is owned by the Fund and the income earned by, and attributable to, that portion.

.03 If a bank is the trustee of more than one pooled income fund, section 1.642(c)-5(b)(3) of the regulations provides that the trustee may maintain a common trust fund to which section 584 of the Code applies for the collective investment and reinvestment of moneys from the pooled income funds.

.04 If a bank is the trustee of the pooled income fund, the following sample provision for a Declaration of Trust satisfies the requirement described in Sec. 5.03:

> All or any portion of the Fund may be invested or reinvested in a common trust fund, maintained by the Trustee, to which section 584 of the Code applies.

.05 A will, trust agreement, or other instrument may be an Instrument of Transfer if it incorporates the Declaration of Trust by reference and is consistent with the provisions of the Declaration of Trust and section 642(c)(5) of the Code.

.06 The following sample provision for a Declaration of Trust satisfies the requirement described in Sec. 5.05:

> This Declaration of Trust may be incorporated by reference in any will, trust agreement, or other instrument that is used to transfer property to Y Pooled Income Fund and to retain or create an income interest for the life of one or more named beneficiaries, each of whom is living at the time of transfer. If property is transferred by an instrument to the Y Pooled Income Fund and the instrument does not incorporate this Declaration of Trust by reference, then the Trustee may accept the property as long as it is not inconsistent with the instrument to hold, manage, and distribute the property according to the Declaration of Trust and section 642(c)(5) of the Code.

SEC. 6. PROHIBITION AGAINST EXEMPT SECURITIES

.01 A pooled income fund must not accept from a donor, or invest in, any securities whose income is exempt from federal income tax. The governing instrument of the pooled income fund must contain specific prohibitions against accepting or investing in exempt securities. (See section 1.642(c)-5(b)(4) of the regulations.)

.02 The following sample provision for a Declaration of Trust satisfies the requirement described in Sec. 6.01:

> The property transferred to Y Pooled Income Fund by any donor shall not include any securities whose income is exempt from the taxes imposed by subtitle A of the Code or corresponding provision of any subsequent federal tax law, and the Trustee of the Fund shall not accept or invest in any such securities as part of the Fund.

SEC. 7. MAINTENANCE BY CHARITABLE ORGANIZATION REQUIRED

.01 The pooled income fund must be maintained by the same public charity to or for the use of which the irrevocable remainder interest is contributed. The requirement of maintenance will be satisfied if the public charity exercises control directly or indirectly over the pooled income fund. (See section 1.642(c)-5(b)(5) of the regulations.)

.02 The following sample provision for a Declaration of Trust satisfies the requirement described in Sec. 7.01:

> Y Public Charity shall always maintain Y Pooled Income Fund or exercise control, directly or indirectly, over the Fund. The Charity retains the power to remove any Trustee or Trustees and to designate a new Trustee or Trustees.

SEC. 8. PROHIBITION AGAINST DONOR OR BENEFICIARY SERVING AS TRUSTEE

.01 A pooled income fund is prohibited from having as a trustee a donor to the fund or a beneficiary (other than the public charity to or for the use of which the remainder interest is transferred) of an income interest in any property transferred to the fund. It is also required that the governing instrument contain this prohibition. The fact that the donor of property to the fund, or a beneficiary of the fund, is a trustee, officer, director, or other official of the public charity to or for the use of which the remainder interest is contributed ordinarily will not prevent the fund from complying with this prohibition. (See section 1.642(c)-5(b)(6) of the regulations.)

.02 The following sample provision for a Declaration of Trust satisfies the requirement described in Sec. 8.01:

> Y Pooled Income Fund shall not have as a Trustee a donor to the Fund or a beneficiary (other than Y Public Charity) of an income interest in any property transferred to the Fund. No donor or beneficiary (other than the Charity) shall have, directly or indirectly, general responsibilities with respect to the Fund that are ordinarily exercised by a Trustee.

SEC. 9. ALLOCATION OF INCOME TO BENEFICIARY

.01 Sections 1.642(c)-5(b)(7) and 1.642(c)-5(c) of the regulations contain or pertain to the following requirements with respect to the income of a beneficiary of a pooled income fund:

(1) Each beneficiary entitled to income of any taxable year of the fund must receive the income in an amount determined by the rate of return earned by the fund for the year with respect to the beneficiary's income interest.

(2) On each transfer of property to the fund by a donor one or more units of participation in the fund must be assigned to the beneficiary or beneficiaries of the income interest in the property, determined by dividing the fair market value of the property by the fair market value of a unit of participation at the time of transfer.

(3) The fair market value of a unit of participation is determined by dividing the fair market value of all property in the fund by the number of units of participation in the fund at the time of the transfer.

(4) If a transfer of property to a fund occurs on other than a determination date, the number of units of participation assigned to the income interest in the property as of the date of transfer, may be determined by using the fair market value of the property in the fund on the determination date immediately preceding the date of transfer, with appropriate adjustments on the next succeeding determination date.

(5) A determination date is each day of the taxable year of the fund on which there is a valuation of property in the fund. The property of the fund must be valued on the first day of every taxable year and on at least 3 other days within the taxable year. There must be no more than 3 calendar months between any two consecutive determination dates.

(6) The share of income allocated to each unit of participation is to be determined by dividing the income of the fund for the taxable year by the outstanding number of units in the fund at the end of the year, with appropriate adjustment for units outstanding during only a part of the year.

(7) The governing instrument of the fund must direct the trustee to distribute income currently or within the first 65 days following the close of the taxable year in which the income is earned.

(8) The governing instrument must provide that the income interest of any designated beneficiary must either be terminated with the last regular payment that was made before the death of the beneficiary or be prorated to the date of the beneficiary's death.

(9) The term "income" has the same meaning as it does under section 643(b) of the Code and the regulations thereunder.

.02 The following sample provisions for a Declaration of Trust satisfy the requirements described in Sec. 9.01:

> The taxable year of Y Pooled Income Fund shall be the calendar year. To each beneficary entitled to income of any taxable year of the Fund, the Trustee of the Fund shall pay income in the amount determined by the rate of return earned by the Fund for the year with respect to the beneficiary's income interest. Payment must be made at least once in the taxable year in which the income is earned. Until the Trustee determines that payments shall be made more or less frequently or at other times, the Trustee shall make income payments to the beneficiary or beneficiaries entitled to them in four quarterly payments on or about March 31, June 30, September 30, and December 31, of each year. An adjusting payment, if necessary, will be made during the taxable year or within the first 65 days following its close to bring the total payment to the actual income to which the beneficiary or beneficiaries are entitled for that year.
>
> On each transfer of property by a donor to the Fund, there shall be assigned to the beneficiary or beneficiaries of the income interest retained or created in the property the number of units of participation equal to the number obtained by dividing the fair market value of the property transferred by the fair market value of a unit in the Fund immediately before the transfer. The fair market value of a unit in the Fund immediately before the transfer shall be determined by dividing the fair market value of all property in the Fund at that time by the number of units then in the Fund. All units in the Fund shall always have equal value.
>
> If a transfer of property to the Fund by a donor occurs on other than a determination date, the number of units of participation assigned to the income interest in the property shall be determined by using the average fair market value of the property in the Fund immediately before the transfer, which shall be deemed to be the average of the fair market values of the property in the Fund on the determination dates immediately preceding and succeeding the date of transfer. For the purpose of determining the average fair market value, the property transferred by the donor and any other property transferred to the Fund between the preceding and succeeding dates, or on such succeeding date, shall be excluded. The fair market value of a unit in the Fund immediately before the transfer shall be determined by dividing the average fair market value of the property in the Fund at that time by the number of units

then in the Fund. Units of participation assigned to property transferred on other than a determination date shall be deemed to be assigned as of the date of transfer.

A determination date means each day within a taxable year of the Fund on which a valuation is made of the property in the Fund. The property of the Fund shall be valued on January 1, April 1, July 1, and October 1 of each year.

The amount of income allocated to each unit of participation in the Fund shall be determined by dividing the income of the Fund for the taxable year by the outstanding number of units in the fund at the end of the year, except that income shall be allocated to units outstanding during only part of the year by taking into consideration the period of time the units are outstanding during the year.

For purposes of this Fund, the term "income" has the same meaning as it does under section 643(b) of the Code or corresponding provision of any subsequent federal tax law, and the regulations thereunder.

The income interest of any beneficiary of the Fund shall terminate with the last regular payment of income that was made before the death of the beneficiary. The Trustee of the Fund shall not be required to prorate any income payment to the date of the beneficiary's death.

SEC. 10. TERMINATION OF LIFE INCOME INTEREST

.01 Upon the termination of the income interest retained or created by any donor, the trustee of the pooled income fund must sever from the fund an amount equal to the value of the remainder interest in the property upon which the income interest is based. The value of the remainder interest must be either (1) its value as of the determination date next succeeding the termination of the income interest or (2) its value as of the date on which the last regular payment was made before the death of the beneficiary if the income interest is terminated on that date. (See section 1.642(c)-5(b)(8) of the regulations.)

.02 The following sample provision for a Declaration of Trust satisfies the requirement described in Sec. 10.01:

> Upon the termination of the income interest of any designated beneficiary or beneficiaries, the Trustee of Y Pooled Income Fund shall sever from the Fund an amount equal to the value of the remainder interest in the property upon which the income interest is based. The value of the remainder interest for that purpose shall be its value as of the date on which the last regular payment was made before the death of the beneficiary. The amount so severed from the Fund shall be paid to Y Public Charity.

.03 A donor may specify a purpose for which the amount severed from a pooled income fund is to be used, upon termination of an income interest of any designated beneficiary or beneficiaries, if the purpose is for the charitable use and purpose of the public charity to or for the use of which the remainder interest is contributed. This specification must not create a contingent remainder interest for the public charity.

.04 The following sample provision for an Instrument of Transfer satisfies the requirement of Sec. 10.03:

> The amount severed from Y Pooled Income Fund upon the termination of the income interest of the designated beneficiaries shall be paid to Y Public Charity for the following charitable use and purpose of the Y Public Charity: ____________. If it is not possible for Y Public Charity to use the severed amount for this specified purpose, then the severed amount will be used for the general purposes of Y Public Charity.

SEC. 11. MISCELLANEOUS

.01 The sample provisions in Sections 3 through 10 are set forth merely as a guide in developing governing instruments for specific pooled income funds and in no way preclude the use of other provisions conforming to the requirements of section 642(c)(5) of the Code and the regulations thereunder.

.02 Provisions corresponding to these sample provisions will be accepted by the Internal Revenue Service in the absence of any showing that they are not enforceable under applicable local law.

SEC. 12. RULINGS ISSUED BY THE NATIONAL OFFICE

Requests for rulings on declarations of trust and instruments of transfer should be submitted in compliance with the general procedures contained in Rev. Proc. 80-20, 1980-1 C.B. 633, pertaining to the issuance of rulings, and should be addressed to the Internal Revenue Service, Assistant Commissioner (Technical), Attention: T:FP:T, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

SEC. 13. EFFECT ON OTHER DOCUMENTS

Rev. Rul. 72-196 is amplified, clarified, and superseded.

Subpart C.—Estates and Trusts Which May Accumulate Income or Which Distribute Corpus

Section 661.—Deduction for Estates and Trusts Accumulating Income or Distributing Corpus

26 CFR 1.661(a)-2: Deduction for distributions to beneficiaries.
(Also Section 663; 1.663(a)-1.)

Estates; distribution; lifetime transfer; equalization directive. The decedent made a lifetime transfer of stock to one of the decedent's two children. The decedent's will provides that the residue of the estate is to be divided equally between the two children, but that the lifetime transfer must be taken into account. The distribution of the residuary estate to one of the two children in accordance with the equalization directive is a distribution in satisfaction of a right to receive a distribution in a specific dollar amount, and the estate may realize gain on a distribution of property in kind.

Rev. Rul. 82-4

ISSUE

Under the circumstances described below, does an estate realize gain for federal income tax purposes when an executor distributes property to one of two heirs to equalize their respective shares?

FACTS

In 1980 *A* gratuitously transferred to *B*, *A*'s adult child, 100,000 shares of *X* company stock. *A* died in 1981. *A*'s will provides that after the payment of debts, expenses, taxes, and the satisfaction of certain specific bequests, the residue of the estate is to be divided equally between the decedent's adult children, *B* and *C*. However, the will further provides that the executor, in determining the allocation of the residue to *B* and *C*, is to take into account the date of death value of the 100,000 shares of stock transferred to *B*. This provision was intended to equalize, to the extent possible, the value of the property transferred to *B* and *C*, taking into consideration the lifetime transfer to *B*. The will also provides that any assets distributed in kind are to be valued at the date of distribution.

At the time of final distribution, the residuary estate consisted solely of 60,000 shares of *X* company stock with a value of $3 per share. The value of the stock at the date of death was $2 per share. Because the value of the residue at the date of distribution ($180,000) was less than the value at the date of death of the stock previously transferred by the decedent to *B* ($200,000), the executor, in accordance with the terms of the decedent's will, distributed the entire residuary estate to *C*.

LAW AND ANALYSIS

Section 661(a) of the Internal Revenue Code provides that in any tax year there shall be allowed as a deduction in computing the taxable income of an estate the sum of (1) any amount of income for the tax year required to be distributed currently (including any amount required to be distributed that may be paid out of income or corpus to the extent the amount is paid out of income for the tax year); and (2) any other amounts properly paid or credited or required to be distributed for the tax year. However, the deduction cannot exceed the distributable net income of the estate.

Section 1.661(a)-2(f)(1) of the Income Tax Regulations provides that an estate does not realize a gain or loss from the distribution of property in kind unless the distribution is in satisfaction of a right to receive a distribution in a specific dollar amount. Under this provision of the regulations, whenever an estate distributes property other than money to any beneficiary in satisfaction of a specific dollar amount, the estate realizes gain or loss measured by the difference between the amount of the bequest satisfied and the basis to the estate of the distributed property. See *Kenan v. Commissioner*, 114 F.2d 217 (2d Cir. 1940); and *Suisman v. Eaton*, 15 F. Supp. 113 (D. Conn. 1935), *aff'd per curiam*, 83 F. 2d 1019 (2d Cir. 1936), *cert. denied*, 299 U.S. 573 (1936).

Section 663(a) of the Code excludes from amounts falling within section 661(a) any amount that, under the terms of the governing instrument, is properly paid or credited as a gift or bequest of a specific sum of money or of specific property.

Section 1.663(a)-1(b)(1) of the regulations provides that in order to qualify as a gift or bequest of a specific sum of money or of specific property under section 663(a) of the Code, the amount of money or the identity of the specific property must be ascertainable under the terms of a decedent's will as of the date of the decedent's death.

In Rev. Rul. 66-207, 1966-2 C.B. 243, the decedent's will created a trust and provided for a bequest of a specific sum of money, 250*x* dollars, to the trust. After payment of all debts, costs of administration, claims, and specific bequests, other than the 250*x* dollars, the estate consisted of assets (including 10*x* dollars in cash) having a fair market value of 200*x* dollars and an aggregate basis to the estate of 150*x* dollars. Rev. Rul. 66-207 holds that the bequest of 250*x* dollars is a "bequest of a specific sum of money" as that term is defined in section 1.663(a)-1(b)(1) of the regulations. The fact that the fair market value of the property remaining in the estate is not equal to the bequest of the specific sum of money does not transform that bequest into a bequest of the residue of the estate. Rather, the bequest of a specific sum has been abated by 50*x* dollars and thereby reduced from 250*x* dollars to 200*x* dollars. Because the distribution is in satisfaction of a bequest of a specific sum of money, as defined by section 1.663(a)-1(b)(1), no amount is deductible by the estate under section 661 of the Code or includible in gross income of the trust under section 662.

Rev. Rul. 66-207 further holds that upon distribution of the property remaining in the estate to the trust, the estate will realize a gain of 50*x* dollars under section 1.661(a)-2(f) of the regulations equal to the difference between the amount of the bequest satisfied by distribution of property other than cash (200*x* dollars less 10*x* dollars cash, or 190*x* dollars) and the basis (150*x* dollars less 10*x* dollars cash or 140*x* dollars) to the estate of the property other than cash so distributed. The effect of the distribution is the same as if the executor of the estate sold the remaining assets of the estate and distributed the proceeds to the trustee.

In the present situation, the decedent's will provides that the residue of the estate is to be divided equally between *B* and *C*. However, in order to equalize to the extent possible the respective shares of *B* and *C*, the executor must take into account the value at the date of death of the stock previously transferred to *B*.

In this case, as in Rev. Rul. 66-207, the residue equal to the value of 100,000 shares of *X* company stock as of date of death bequeathed to *C* is a "bequest of a specific sum of money," as that term is defined in section 1.663(a)-1(b)(1) of the regulations, because the amount is ascertainable under the terms of *A*'s will as of the date of A's death. Thus, no amount is deductible by the estate under section 661 of the Code or includible in the gross income of *B* under section 662. Also, under section 1.661(a)-2(f)(1), the estate realizes a gain on the distribution in kind of appreciated property in satisfaction of *C*'s right to receive a distribution in a specific dollar amount.

HOLDING

The estate realizes gain of $60,000 (date of distribution value ($180,000) less the basis of the property in the estate ($120,000)) for federal income tax purposes when the executor distributes the entire residuary estate to *C* to equalize to the extent possible the respective shares of total transfers received from the decedent.

If in this case the value of the residuary estate had been, for example, $250,000, the property remaining after satisfaction of the $200,000 bequest to *C* ($50,000) would pass to *B* and *C* in equal shares. The estate would realize no gain or loss under section 1.661(a)-2(f)(1) of the regulations upon distribution of this portion of the $50,000 residue because the distribution would not be in satisfaction of the right to receive a distribution in a specific dollar amount.

Section 663.—Special Rules Applicable to Sections 661 and 662

26 CFR 1.663(a)-1: Special rules applicable to sections 661 and 662; exclusions; gifts, bequests, etc.

Whether an estate realizes gain when an executor distributes property to one of two heirs in order to equalize their respective shares. See Rev. Rul. 82-4, page 99.

Subpart E.—Grantors and Others Treated as Substantial Owners

Section 671.—Trust Income, Deductions, and Credits Attributable to Grantors and Others as Substantial Owners

26 CFR 1.671-2: Applicable principles.

What are the tax consequences to a corporation that makes contributions to a trust formed to pay the corporation's obligations under the state workmen's compensation act. See Rev. Rul. 82-95, below.

---

26 CFR 1.671-3: Attribution or inclusion of income, deductions, and credits against tax.

What are the tax consequences to a corporation that makes contributions to a trust formed to pay the corporation's obligations under the state workmen's compensation act. See Rev. Rul. 82-95, below.

Section 677.—Income for Benefit of Grantor

26 CFR 1.677(a)-1: Income for benefit of grantor; general rule.
(Also Sections 162, 671; 1.162-10, 1.671-2, 1.671-3.)

Grantor trusts; employer contributions. Contributions by an employer to a trust formed to pay its obligations to its employees under the state workmen's compensation act are not deductible under section 162 of the Code until the trust actually pays benefits to the employees because the trust is a grantor trust. Rev. Rul. 72-191 distinguished and Rev. Rul. 71-209 distinguished and clarified.

Rev. Rul. 82-95

ISSUE

If a corporation funds its potential liabilities under a state workmen's compensation act by regular contributions to a trust dedicated to discharging such liabilities, may the corporation deduct under section 162 of the Internal Revenue Code its contributions at the time they are made?

FACTS

Under the workmen's compensation act of state *ST*, employers in *ST* must provide compensation for the benefit of their employees in the event of injury, sickness, or death occurring in the course of their employment. *X*, a corporation that conducts business in *ST*, contributes to a trust that it formed to provide such compensation for its own employees. The trust, however, was not created pursuant to a collective bargaining agreement and the trust does not qualify for exemption under section 501(c)(9) of the Code.

Although the contributions have been determined actuarially to be sufficient to cover all claims and expenses, the contributions do not discharge *X*'s legal obligation to pay workmen's compensation benefits. No part of the corpus or income of the trust will vest in *X* or be used for any purpose other than paying claims. Neither *X* nor its officers have any power of administration of the trust.

LAW AND ANALYSIS

Section 677(a) of the Code provides that a grantor is treated as the owner of any portion of a trust whose income (1) is distributed to the grantor without the approval or consent of any adverse party, or (2) in the discretion of the grantor or a nonadverse party or both, may be distributed to the grantor without the approval or consent of any adverse party.

Section 1.677(a)-1(d) of the Income Tax Regulations provides, in general, that a grantor is treated as the owner of a portion of a trust whose income (1) is applied in discharge of a legal obligation of the grantor, or (2) in the discretion of the grantor or a nonadverse party or both, may be applied in discharge of a legal obligation of the grantor.

Section 671 of the Code provides that when the grantor is treated as the owner of any portion of a trust, the grantor's taxable income and credits include those items of the trust's income, deductions, and credits attributable to the portion of the trust that the grantor is treated as owning.

Section 1.671-2(c) of the regulations provides that an item of income, deduction, or credit included in computing a grantor's taxable income and credits is treated as if the grantor (whether or not an individual) had received or paid it directly.

Section 1.671-3(a)(1) of the regulations provides that if the grantor is treated as the owner of an entire trust, the grantor takes into account in computing income tax liability all items of income, deduction, and credit to which the grantor would have been entitled if the trust had not been in existence during the period the grantor is treated as the owner.

Section 1.671-2(e) of the regulations provides that the term "grantor" includes a corporation.

Section 162 of the Code allows as a deduction all the ordinary and necessary expenses paid or incurred during the tax year in carrying on any trade or business.

Section 1.162-10(a) of the regulations provides that (1) amounts paid or accrued by a taxpayer because of injuries received by employees, and (2) lump-sum amounts paid or accrued as compensation for injuries are proper deductions as ordinary and necessary expenses. In addition, amounts paid or accrued within the tax year for a sickness, accident, hospitalization, medical expense, or similar benefit plan are deductible under section 162(a) of the Code if they are ordinary and necessary expenses of the trade or business.

In Rev. Rul. 71-209, 1971-1 C.B. 53, an employer made contributions under a private plan established under title 43, Chapter 21 of the Revised Statutes of New Jersey, to provide for payment of nonoccupational disability benefits to employees. The revenue ruling concludes that these contributions are deductible as ordinary and necessary business expenses under section 162(a) of the Code.

Rev. Rul. 72-191, 1972-1 C.B. 45, concludes that employer contributions to a fund maintained by the state under the New York Workmen's Compensation Law to pay occupational and nonoccupational disability benefits are ordinary and necessary business expenses deductible by the employer under section 162 of the Code.

In the present case, because the trust's income and corpus are used to discharge *X*'s legal obligations to its employees, *X* is considered the owner of the entire trust under section 677(a) of the Code. Under section 671, *X* must include the trust's items of income, deduction, and credit in computing its taxable income. Under section 1.671-3(a)(1) of the regulations, *X* may deduct the compensation benefits when they are paid or accrued by the trust, subject to the rules of section 461. *X* may not deduct payments into the trust. See Rev. Rul. 57-390, 1957-2 C.B. 326, which concludes that the method of accounting used by a grantor trust is disregarded and gross income from the trust properties must be determined by the grantor as if the trust had not been created.

Rev. Rul. 71-209 and Rev. Rul. 72-191 both conclude that an employer's payments to provide for the payment of disability benefits to employees are deductible under section 162 of the Code. In Rev. Rul. 72-191 the payments did not represent contributions to a trust; under the facts in Rev. Rul. 71-209, it is possible the payments could have represented contributions to a trust although this is not specifically stated. Thus, Rev. Rul. 72-191 and Rev. Rul. 71-209, to the extent the payments were made to a state-administered fund under the New York statute or similar state law, to insurance carriers, or directly to the employees, section 671 has no application. If, on the other hand, the payments in either revenue ruling had been made to a trust then they would be deductible only in accordance with the principles in this revenue ruling.

HOLDING

The contributions by *X* to the trust are not deductible under section 162 of the Code. Instead, *X* is allowed a deduction under section 1.162-10(a) of the regulations when the liabilities under the workmen's compensation act of *ST* are paid or accrued pursuant to the method of accounting used by *X*.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 72-191 is distinguished.

Rev. Rul. 71-209 is distinguished and clarified to conform with the conclusion reached in this revenue ruling.

Part II.—Income in Respect of Decedents

Section 691.—Recipients of Income in Respect of Decedents

26 CFR 1.691(a)-1: Income in respect of a decedent.

Whether the proceeds of the sale of a deceased taxpayer's personal residence by the decedent's estate is income in respect of a decedent where the taxpayer had entered into a binding contract to sell the residence prior to the taxpayer's death. See Rev. Rul. 82-1, page 26.

Subchapter K.—Partners and Partnerships
Part III.—Definitions

Section 761.—Terms Defined

26 CFR 1.761-2: Exclusion of certain unincorporated organizations from the application of all or part of subchapter K of chapter 1 of the Code.

Whether participants in a venture formed for the purpose of operating an electric generating facility may elect under section 761(a) of the Code to have the venture excluded from the application of subchapter K, chapter 1 of the Code. Also whether the relationship created through the ownership of an undivided interest in a facility by a utility corporation and a subsidiary of a financial institution, when the subsidiary is leasing its interest in the facility to a utility, is that of partners in a partnership or merely that of coowners of an electric generating facility. See Rev. Rul. 82-61, page 13.

Subchapter L.—Insurance Companies
Part I.—Life Insurance Companies
Subpart A.—Definition; Tax Imposed

Section 801.—Definition of Life Insurance Company

26 CFR 1.801-8: Contracts with reserves based on segregated asset accounts.

Whether the life insurance company or the policyholder is the owner for federal income tax purposes of the mutual fund shares under the circumstances described in the revenue ruling. See Rev. Rul. 82-54, page 11.

26 CFR 1.801-8: Contracts with reserves based on segregated asset accounts.

Clarification of certain provisions of Rev. Rul. 81-225, relating to the circumstances in which the policyholder of certain annuity contracts ("wraparound annuities") would be treated for federal income tax purposes as the owners of the mutual fund shares held by the insurance company in connection with those annuities. See Rev. Rul. 82-55, page 12.

Subpart C.—Gain and Loss from Operations

Section 809.—In General

26 CFR 1.809-5: Deductions.

Life insurance companies; indemnity reinsurance agreement. The amount paid by a reinsuring life insurance company under an indemnity reinsurance agreement as consideration for the reinsurance of a block of life insurance policies must be treated as a deferred expense and amortized over the period covered by the agreement.

Rev. Rul. 82-69

ISSUE

May the amounts paid by the reinsurer to the primary insurer under an indemnity reinsurance agreement be deducted in full in the year accrued or must they be treated as a deferred expense and amortized?

FACTS

On January 1, 1982, *X* (the reinsurer), a life insurance company taxable under section 802 of the Internal Revenue Code, entered into an indemnity reinsurance agreement with *Y* (the reinsured), also a life insurance company taxable under section 802. Under the agreement, beginning on January 1, 1982, *X* agreed to reinsure 90 percent of *Y*'s retained and future risks on a block of life insurance policies written by *Y*. *Y* agreed to pay to *X* 90 percent of all gross premiums received on the policies after January 1, 1982, less an annual commission that was intended to reimburse *Y* for a proportionate part of the administrative and service costs associated with the policies. In addition, upon execution of the agreement, *X* paid to *Y* an amount equal to 200 percent of the estimated gross premium receivable in 1982, on the risk reinsured. The indemnity reinsurance agreement labeled this payment by *X* a "ceding commission" and stated that its purpose was to reimburse *Y* for agents' commissions and other expenses associated with selling and maintaining the reinsured policies that were incurred by *Y* before the effective date of the reinsurance agreement. The agreement provides that after 20 years *Y* may terminate the reinsurance agreement.

LAW AND ANALYSIS

Section 1.809-4(a)(1)(iii) of the Income Tax Regulations defines the term "reinsurance ceded" as an arrangement whereby the reinsured remains solely liable to the policyholder, whether all or only a portion of the risk has been transferred to the reinsurer. This term includes indemnity reinsurance transactions.

Section 809(d)(11) of the Code provides that a life insurance company is allowed, as a deduction in computing gain or loss from operations, all other deductions allowed under Subtitle A for purposes of computing taxable income to the extent not allowed as deductions in computing investment yield.

Section 818(a) of the Code provides that all computations entering into the determination of taxes imposed by Chapter 1 of the Code relating to the taxation of life insurance companies must remain under the accrual method of accounting or, to the extent permitted by the regulations, under a combination of an accrual method of accounting with any other method permitted by Chapter 1 other than the cash receipts and disbursements method.

Section 461(a) of the Code provides the general rule that the amount of any deduction or credit allowed by Subtitle A must be taken for the tax year that is the proper tax year under the method of accounting used in computing taxable income. Section 1.461-1(a)(2) of the regulations provides that a taxpayer using an accrual method of accounting may deduct an expense in the tax year in which all the events have occurred that determine the fact of the liability and the amount of the liability can be determined with reasonable accuracy. However, any expenditure that results in the creation of an asset having a useful life that extends substantially beyond the close of the tax year may not be deductible or may be deductible only in part, for the tax year in which incurred.

Under the facts described, *X* makes two types of payments to *Y*, both of which may be generally called "ceding commissions" and both of which could be construed as expenses that create an asset with a useful life beyond the tax year. To place the indemnity reinsurance agreement on its books, *X* pays an "up-front ceding commission," which is similar to an agent's commission paid by a primary insurer. See discussion in *Colonial Surety Company v. United States*, 178 F. Supp. 600, 602 (Ct. Cl. 1959). However, unlike an agent's commission that is paid with respect to an individual policy that may be cancelled at an time, the "up-front ceding commission" is paid with respect to the acquisition of an agreement or contract with a readily determinable useful life—20 years.

Under the same indemnity reinsurance agreement *X* also pays an "annual ceding commission" that is netted annually from the allocable premiums paid by *Y* to *X*. Situations (1) of Rev. Rul. 79-138, 1979-1 C.B. 359, recognizes an annually paid ceding commission as such even though it is netted from the gross premiums paid by the primary insurer to the reinsurer. See also Rev. Rul. 70-552, 1970-2 C.B. 141, for another description of a reinsurance arrangement calling for an annual ceding commission. Unlike the "up-front ceding commission," the "annual ceding commission" is more closely associated with the individual risks reinsured and represents *X*'s allocable share of the current expenses of the individual contracts issued by *Y*. Thus, the "annual ceding commissions" more closely parallel the primary insurer's expenses for individual policies, which when viewed separately have no readily determinable useful life.

HOLDING

The "up-front ceding commission" (200 percent of 1982 gross premiums) paid by *X* to *Y* represents an acquisition cost of a block of business, embodied in the indemnity reinsurance agreement, with a readily determinable useful life extending beyond the close of the tax year and thus must be amortized over the term of the agreement. A current deduction for the annual amount to be amortized is allowable under section 809(d)(11) of the Code.

Under Rev. Rul. 79-138, the amount annually netted from the gross premiums paid by *Y* to *X* is viewed as an "annual ceding commission." This amount, which represents reimbursement of current expenses relating to individual contracts, may be deducted by *X* in full as accrued.

Subpart E.—Miscellaneous Provisions

Section 819.—Foreign Life Insurance Companies

26 CFR 1.819-2: Foreign life insurance companies.

Percentage to be used in computing income tax for taxable year 1981 and established tax for taxable year 1982. See Notice 82-11, page 359.

Subchapter M.—Regulated Investment Companies and Real Estate Investment Trusts
Part I.—Regulated Investment Companies

Section 851.—Definition of Regulated Investment Company

26 CFR 1.851-1: Definition of regulated investment company.
(Also Section 544; 1.544-3.)

Regulated investment company; constructive ownership. A corporation will lose its status as a regulated investment company if, because of constructive ownership by reason of partnership attribution rules, it becomes a personal holding company.

Rev. Rul. 82-107

ISSUE

Will the taxpayer lose its status as a regulated investment company because it will become a personal holding company, under the circumstances described below?

FACTS

The taxpayer is a corporation that qualifies as and has elected to be taxed as a regulated investment company under section 851 of the Internal Revenue Code. The taxpayer proposes to sell a large number of its shares to individual investors who also are investors in syndicated limited partnerships set up by the taxpayer's investment advisor. The investors are limited partners and are not active in partnership operations.

After the proposed stock sale, four individual shareholders of the taxpayer who do not own interests in any partnership, will own respectively 8, 7, 6, and 5 percent of the taxpayer's stock. In addition, *A*, an individual owning limited partnership interests in two partnerships, owns 4 percent of taxpayer's stock. In the first partnership, two individuals, other than *A*, who are limited partners, together will own 11 percent of the taxpayer's stock. In the second partnership, one individual, other than *A*, who is a limited partner, will own 10 percent of the taxpayer's stock. Thus, four individuals who do not own any partnership interests will own a total of 26 percent of the taxpayer's stock. *A* and the three other individual investors in the partnerships will own a total of 25 percent of the taxpayer's stock.

Ninety percent of the taxpayer's gross income consists of dividends and interest (personal holding company income), and that portion is 100 percent of its adjusted ordinary gross income within the meaning of section 543(b)(2) of the Code.

LAW AND ANALYSIS

Section 851 of the Code provides that a domestic corporation, *other than a personal holding company*, that meets certain specific requirements may elect to be taxed as a regulated investment company.

Section 542(a) of the Code defines a personal holding company as any corporation if (1) at least 60 percent of its adjusted ordinary gross income for the tax year is personal holding company income, and, (2) five or fewer individuals own more than 50 percent in value of its outstanding stock at any time during the last half of its tax year.

Section 544(a)(2) of the Code states than an individual shall be considered to own the stock owned by or for the individual's partner.

Section 7701(a)(2) of the Code defines a "partner" as a member in a syndicate, group, pool, joint venture, or organization.

The taxpayer meets the first definitional requirement of a personal holding company because of the nature and amount of its adjusted ordinary gross income. Thus, whether the second requirement, the stock ownership test, is met will be determinative of its status.

The term "partner" is defined broadly. This broad definition means that a partner includes limited partners in a syndicated limited partnership. Pursuant to section 544(a)(2) of the Code, *A* will be considered to own, in addition to the 4 percent of the taxpayer's stock that *A* owns outright, the 11 percent of the taxpayer's stock owned by *A*'s two limited partners in the first partnership, and the 10 percent of the taxpayer's stock owned by *A*'s limited partner in the second partnership. Therefore, *A*'s total stock holdings in the taxpayer will be 25 percent for purposes of the constructive ownership rules of section 544. When that amount is added to the 26 percent held by the four individuals who are not limited partners, the result is that five individuals will own 51 percent of the taxpayer's outstanding stock.

Because five or fewer individuals will be considered to own more than 50 percent of the taxpayer's outstanding shares, the stock ownership test of section 542(a) of the Code is met. Thus, the taxpayer will become a personal holding company if these five individuals continue to own more than 50 percent of the taxpayer's stock at any time during the last half of the taxpayer's tax year. See section 542(a)(2). Because regulated investment company status is determined on a tax year basis, a loss of regulated investment company status will be effective as of the beginning of the tax year.

HOLDING

The taxpayer will lose its status as a regulated investment company when it becomes a personal holding company, effective as of the beginning of the tax year.

Subchapter N.—Tax Based on Income from Sources Within or Without the United States
Part II.—Nonresident Aliens and Foreign Corporations
Subpart B.—Foreign Corporations

Section 882.—Tax on Income of Foreign Corporations Connected With United States Business

26 CFR 1.882-1: Taxation of foreign corporations treated as having effectively connected income.

Whether the gain realized by a Guamanian corporation on its sale of United States real property is taken into account under section 882(a)(1) as income effectively connected with a United States business. See Rev. Rul. 82-114, below.

Subchapter C.—Miscellaneous Provisions

Section 897.—Disposition Of Investment In United States Real Property

(Also Sections 882, 6039C; 26 CFR 1.882-1.)

Foreign corporation; disposition of investment in U.S. real property. A corporation organized under the laws of Guam is a foreign corporation for purposes of section 897 of the Code, and therefore, gain or loss from the disposition of U.S. real estate will be taken into account under section 882. The Guamanian corporation will be subject to the reporting requirements of section 6039C as well. Rev. Rul. 56-616 obsoleted.

Rev. Rul. 82-114

ISSUE

Is *FX*, a corporation organized under the laws of Guam, a foreign corporation for purposes of sections 897 and 6039C of the Internal Revenue Code?

FACTS

FX, a corporation organized under the laws of Guam, owned a parcel of real property located in the United States. Subsequent to June 18, 1980, *FX* disposed of it at a gain.

FX is not engaged in a trade or business within the United States and has never filed an election under section 882(d) of the Code.

LAW AND ANALYSIS

Section 897(a)(1)(B) of the Code provides that gain or loss from the disposition of a United States real property interest by a foreign corporation will be taken into account under section 882(a)(1) as if the foreign corporation were engaged in a trade or business in the United States and the gain or loss was effectively connected with such trade or business. Section 882(a)(1) imposes a tax on a foreign corporation engaged in a trade or business in the United States on its taxable income effectively connected with the conduct of a trade or business in the United States.

Section 7701(a)(4) of the Code defines the term "domestic" when applied to a corporation to mean any corporation "organized in the United States or under the law of the United States or of any State." Sections 7701(a)(9) and (a)(10) define the terms "United States" and "State" to mean only the States and the District of Columbia. Section 7701(a)(5) defines the term "foreign" when applied to a corporation to mean any corporation "which is not domestic."

Rev. Rul. 56-616, 1956-2 C.B. 589, holds, in part, that corporations organized or created under the laws of any possession of the United States including Guam are treated as foreign corporations because they are not organized in the United States or under the law of the United States or of any State.

Certain Code sections have been enacted which provide that, for limited purposes, a corporation organized under the laws of Guam is not a foreign corporation. Section 881(b) of the Code provides that a Guamanian corporation is not a foreign corporation for purposes of the tax on income of foreign corporations not connected with United States business as provided in section 881(a). Likewise, section 1442(c) of the Code provides that a Guamanian corporation is not a foreign corporation for purposes of the withholding tax on foreign corporations as provided in section 1442(a).

The effect of the enactment of sections 881(b) and 1442(c), as added to the Code by P.L. 92-606, 92d Cong., 2d Sess (1972), 1972-2 C.B. 709, and effective with respect to taxable years beginning after December 31, 1971, is to reverse the substantive holding in Rev. Rul. 56-616, which holds that a Guamanian corporation is subject to section 1442(a) withholding tax on its United States investment income. Although Rev. Rul. 56-616 is obsolete as to the application of section 1442(a) to Guamanian corporations, the rationale in that ruling defining the term "foreign" when applied to a corporation is still applicable unless some exception, such as section 881(b) or 1442(c), is applicable. *See* H. Rep. No. 92-1479, 92d Cong., 2d Sess. 1 (1972), 1972-2 C.B. 760, 761, accompanying P.L. 92-606, which provides that, with the exception of sections 881(b) and 1442(c), Guamanian corporations "treated as foreign corporations under present [U.S.] law. . .continue to be treated as such." There is no exception which would exclude a Guamanian corporation from being a foreign corporation for purposes of section 897 and 882 of the Code.

HOLDING

FX, a corporation organized under the laws of Guam, is a foreign corporation for purposes of sections 897 and 6039C of the Code, and the gain from the disposition of the United States real estate will be taken into account under section 882(a)(1).

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 56-616 is hereby obsoleted.

Part III.—Income From Sources Without the United States
Subpart A.—Foreign Tax Credit

Section 901.—Taxes of Foreign Countries and of Possessions of United States

26 CFR 4.901-2: Income, war profits, or excess profits taxes paid or accrued.
(Also Section 903; 4.903-1.)

Foreign tax credit. The enumerated taxes imposed by various foreign countries or provinces have been determined to be creditable income taxes for purposes of the foreign tax credit.

Rev. Rul. 82-119

The Internal Revenue Service has determined that the following charges are creditable income taxes for purposes of sections 901 and 903 of the Internal Revenue Code and sections 4.901-2 and 4.903-1 of the Temporary Income Tax Regulations, T.D. 7739, 1981-1 C.B. 396.

This ruling does not bear upon the issue of whether a listed tax has been paid or accrued. Nor does the ruling deal with contractual modifications of a listed tax. Finally, certain listed taxes are held creditable for specified types of taxpayers. These limitations do not reflect any determination with regard to taxpayers not specified.

CANADA

1. Income Tax Act, S.C. 1970-71-72, c. 63, in effect on December 15, 1979 (Corporation Tax).
2. Section 219, Part XIV, S.C. 1970-71-72, c. 63, in effect on December 15, 1979 (Canadian Branch Tax).
3. Alberta Income Tax Act, R.S.A. 1970, c. 182, in effect on April 1, 1980.
4. Income Tax Act, 1962 of British Columbia, S.B.C. 1962, c. 27, in effect on April 1, 1980.
5. Income Tax Act of Nova Scotia, R.S.N.S. 1967, c. 134, in effect on April 1, 1980.
6. Income Tax Act of Saskatchewan, R.S.S. 1978, c. I-2, in effect on April 1, 1980.
7. Income Tax Act of Newfoundland, R.S. Nfld. 1970, c. 163, in effect on April 1, 1980.

EGYPT

1. Arab Republic of Egypt, Law No. 14, in effect on July 20, 1978 (Book 1) only as applied by Article 11 to foreign companies that have operations extending to countries other than Egypt.

FRANCE

1. French Company Income Tax, Art. 205, General Tax Code, in effect in January 1980, to the ex-

tent that it exceeds the minimum tax, and excluding application to French headquarters of foreign companies.

GERMAN FEDERAL REPUBLIC (WEST GERMANY)

1. Corporation Tax Law, in effect on January 31, 1980.

JAMAICA

1. Section 32(1), Income Tax Act, 1954, in effect on December 31, 1978, as imposed on open companies (Company Profits Tax).
2. Section 33(1), Income Tax Act, 1954, in effect on December 31, 1978 as imposed on open companies (Additional Company Profits Tax).

JAPAN

1. Corporation Tax Law, Law No. 34, March 31, 1965, in effect on April 1, 1979, as imposed on corporations not engaged in the exploitation, development, extraction, transportation, processing or sale of natural resources.

LIBYA

1. Tax on Companies, Art. 93, Law No. 64 (1973), in effect on October 1, 1973.

MEXICO

1. Art. 34, Income Tax Law, in effect on September 30, 1980.
2. Art. 41-VI, Income Tax Law, in effect on September 30, 1980.

PERU

1. Art. 1 (Art. 20 Third Category), Supreme Decree 287-68-HC, in effect on December 31, 1981.
2. Art. 61(b), Supreme Decree 287-68-HC, in effect on December 31, 1981.

THAILAND

1. Sections 66 and 70 bis, Revenue Code, in effect on December 30, 1979.
2. Section 65 quarter (1) and (2), Petroleum Income Tax B.E. 2514, in effect on December 30, 1979.

UNITED KINGDOM

1. Income and Corporation Taxes Act of 1970, in effect on January 1, 1979 (Corporation Tax only).

Section 903.—Credit For Taxes in Lieu of Income, Etc., Taxes

26 CFR 4.903-1: Taxes in lieu of income taxes.

The enumerated taxes imposed by the respective foreign countries or provinces are allowable income taxes. See Rev. Rul. 82-119, page 105.

Subpart F.—Controlled Foreign Corporations

Section 951.—Amounts Included in Gross Income of United States Shareholders

26 CFR 1.951-1: Amounts included in gross income of United States shareholders.

Whether, under the circumstances described, a dividend received by a controlled foreign corporation from its wholly owned subsidiary is included in the controlled foreign corporation's subpart F income. See Rev. Rul. 82-16, below.

Section 952.—Subpart F Income Defined

26 CFR 1.952-1: Subpart F income defined.

Whether under the circumstances described, a dividend received by a controlled foreign corporation from its wholly owned subsidiary is subpart F income. See Rev. Rul. 82-16, below.

Section 959.—Exclusion From Gross Income Of Previously Taxed Earnings and Profits

26 CFR 1.959-2: Exclusion from gross income of controlled foreign corporations of previously taxed earnings and profits.
(Also Sections 951, 952; 1.951-1, 1.952-1.)

Subpart F income; distribution to controlled foreign corporation of previously taxed income. A distribution from earnings and profits attributable to subpart F income by a wholly owned foreign subsidiary is excluded from the controlled foreign corporation's subpart F income under section 959(b) of the Code if a pro rata share of the distribution has been included in its U.S. shareholder's income under section 951(a).

Rev. Rul. 82-16

ISSUE

To what extent is a dividend received by a controlled foreign corporation from its wholly owned foreign subsidiary, under the circumstances described below, excluded from the controlled foreign corporation's "subpart F income" under section 959(b) of the Internal Revenue Code for purposes of applying section 951(a) to its United States shareholder?

FACTS

P, a domestic corporation, owns 70 percent of the only class of stock of *S*. *S*, a corporation formed under the laws of country *X*, is a "controlled foreign corporation" under section 957(a) of the Code, and *P* is a "United States shareholder" under section 951(b). The remaining 30 percent of the stock of *S* is held by non-United States shareholders.

S-1, a corporation formed under the laws of country *Y*, is a wholly owned subsidiary of *S*. *S-1* is a "controlled foreign corporation" under section 957(a) of the Code by reason of the direct and indirect ownership rules of section 958(a), and *P* is a "United States shareholder" of *S-1* under sections 951(b) and 958(a). During its tax year ending September 30, 1980, *S-1* had "subpart F income" of 100*x* dollars and other income of 50*x* dollars. *S-1*'s accumulated earnings and profits exceed 250*x* dollars, none of which are attributable to amounts previously included in *P*'s gross income under section 951(a). On September 30, 1980, *S-1* distributed 200*x* dollars in cash to *S*.

LAW AND ANALYSIS

Section 951(a)(1)(A)(i) of the Code provides that if a foreign corporation is a controlled foreign corporation for an uninterrupted period of 30 days or more during any tax year, every person who is a United States shareholder (as defined in section 951(b)) of the corporation and who owns (within the meaning of section 958(a)) stock in the corporation on the last day in the year on which the corporation is a controlled foreign corporation shall include in its gross income, for its tax year in which or with which the tax year of the corporation ends, its pro rata share of the corporation's "subpart F income" for that year.

Section 952(a)(2) of the Code provides that "subpart F income" includes, for any controlled foreign corporation, the foreign base company income as determined under section 954.

Section 954(a)(1) of the Code provides that "foreign base company income" for any tax year includes the foreign personal holding company income for the tax year determined under section 954(c) and reduced as provided in section 954(b)(5).

Section 954(c)(1) of the Code provides that the term "foreign personal holding company income" means the foreign personal holding company income as defined in section 553, with certain modifications and adjustments not relevant here.

Section 553(a)(1) of the Code provides that the term "foreign personal holding company income" includes that portion of gross income that consists of dividends.

Section 959(b) of the Code provides that, for purposes of section 951(a), the earnings and profits for a tax year of a controlled foreign corporation attributable to amounts that are, or have been, included in the gross income of a United States shareholder under section 951(a) shall not, when distributed through a chain of ownership described under section 958(a), be also included in the gross income of another controlled foreign corporation in the chain for purposes of applying section 951(a) to the other controlled foreign corporation with respect to the United States shareholder.

The 100*x* dollars of income constitutes "subpart F income" to *S-1* as defined in section 952(a) of the Code because under section 1.952-1(c)(1) of the Income Tax Regulations "subpart F income" for a tax year is computed as of the close of the tax year without diminution for any distributions made during the tax year. As a result, under section 951(a)(1)(A)(i), *P* must include in its gross income for its tax year in which or with which the tax year of *S-1* ends its pro rata share of *S-1*'s "subpart F income" for the year ending September 30, 1980, which amounts to 70*x* dollars (70 percent X 100*x* dollars).

Under sections 952(a)(2), 954(a)(1) and (c), and 553(a)(1) of the Code, the dividends received by *S* from *S-1* constitute "subpart F income" to *S* except to the extent the exclusion provisions of section 959(b) apply to the distribution. Section 959(b) was enacted for the specific purpose of preventing the income of a controlled foreign corporation, having once been included in the gross income of a United States shareholder, from being included in the gross income of the United States shareholder a second time when the income is distributed to another controlled foreign corporation. *See Technical Explanation of S. Rep. No. 1881*, 87th Cong., 2d Sess. 137, 256 (1962) 1962-3 C.B. 841, 960.

However, the question exists whether the provisions of section 959(b) of the Code apply to exclude only 70*x* dollars (*P*'s pro rata portion of *S-1*'s income included in *P*'s income) from *S*'s gross income or whether the exclusion applies to the entire 100*x* dollars of *S-1*'s earnings and profits that are attributable to the 70*x* dollars included in *P*'s gross income. The exclusionary language of section 959(b) looks to the total amount of earnings and profits of the controlled foreign corporation that caused the United States shareholder to be in receipt of gross income under section 951(a). The amount of *S-1*'s earnings and profits that caused *P* to be in receipt of 70*x* dollars of gross income is 100*x* dollars. Further, if the exclusion of section 959(b) were limited to that portion of the distribution included in *P*'s income (70*x* dollars) under section 951(a)(1)(A)(i), it would result in the inclusion in *P*'s gross income of more than its pro rata share of *S-1*'s income. This results because the 30*x* dollars not excluded would be considered "subpart F income" in the hands of *S* and *P*'s pro rata share of 21*x* dollars (70 percent X 30*x* dollars) would be required to be included in *P*'s income in addition to the 70*x* dollars of "subpart F income" already included from the *S-1* level. Therefore, only by excluding 100*x* dollars from *S*'s "subpart F income" can the stated purpose of section 959(b) of preventing the inclusion of previously taxed "subpart F income" (based on the amount of *S-1*'s earnings and profits attributable thereto) be achieved.

Because section 959(b) of the Code excludes 100*x* dollars from *S*'s "subpart F income" of 200*x* dollars, P also must include in its gross income for the same tax year its pro rata share of the remaining 100*x* dollars of *S*'s "subpart F income," which is 70x dollars (70 percent X 100*x* dollars).

HOLDING

A portion of the dividend received by a controlled foreign corporation from its wholly owned foreign subsidiary, under the circumstances described above, is excluded from the controlled foreign corporation's "subpart F income" under section 959(b) of the Code for purposes of apply section 951(a) to its United States shareholder.

Part IV.—Domestic International Sales Corporations
Subpart A.—Treatment of Qualifying Corporations

Section 993.—Definitions

26 CFR 1.993-2: Definition of qualified export assets.

Export assets; goodwill. Goodwill acquired by a DISC upon purchase of an ongoing export sales business is a qualified export asset under section 993(b)(2) of the Code.

Rev. Rul. 82-18

ISSUE

Is good will acquired by a Domestic International Sales Corporation (DISC) upon the purchase of an ongoing export sales business a qualified export asset under section 993(b)(2) of the Internal Revenue Code?

FACTS

X was incorporated by *Y*, its parent, and made an election to be treated as a DISC for its first tax year. *X* then purchased, in an arm's length transaction, all the assets of *Z*, an unrelated corporation engaged solely in the export sales business. Each asset acquired by *X* was separately listed and priced in a sales contract between *X* and *Z* after negotiations involving the various assets. Good will, represented by a list of foreign customers of *Z*, was among the assets purchased by *X* from *Z*. *X* owned no assets other than cash, and conducted no business from the time of its formation and DISC election until its purchase of *Z*'s assets. All the employees of *Z* at the time of the purchase continued in the employ of *X*.

X entered into a DISC sales agency agreement with *Y* and other domestic supplier corporations. *X*'s export sales were derived from the continuing operations of the export business acquired from *Z* and from the export sales of products manufactured by *X*'s parent.

LAW AND ANALYSIS

Section 992(a)(1)(B) of the Code provides that for a corporation to qualify as a DISC the adjusted basis of the corporation's qualified export assets, as defined in section 993(b), at the close of the tax year must equal or exceed 95 percent of the sum of the adjusted basis of all assets of the corporation at the close of the tax year.

Section 993(b) of the Code lists nine categories of qualified export assets of a DISC. The first category is "export property," as defined in section 993(c). Section 993(c)(1) defines export property as property that is manufactured, produced, grown, or extracted in the United States by a person other than a DISC and that is held primarily for sale or rental, in the ordinary course of trade or business, by or to a DISC for use outside the United States. Section 993(c)(2)(B) excludes "good will" from the term "export property."

The second category of qualified export assets is set forth in section 993(b)(2) of the Code. It includes assets used primarily in connection with the sale, lease, rental, storage, handling, transportation, packaging, assembly, or servicing of export property. Section 1.993-2(a)(2) of the Income Tax Regulations refers to this category as "business assets."

The purpose of the DISC provisions is to stimulate export trade. *See* H. Rep. No. 95-533, 92d Cong., 1st Sess. 58 (1971), 1972-1 C.B. 498, 529; S. Rep. No. 92-437, 92d Cong., 1st Sess. 90 (1971), 1972-1 C.B. 559, 609. The purpose of the 95 percent qualified export asset test is to insure that substantially all of the DISC's assets are export related. H. Rep. No. 92-533, 92d Cong., 1st Sess. 9 (1971), 1972-1 C.B. 498, 502-503; S. Rep. No. 92-437, 92d Cong., 1st Sess. 12 (1971), 1972-1 C.B. 559, 565.

Good will is an intangible asset that gives rise not only to continued earning capacity but also to some competitive advantage or continued patronage. *VGS Corp. v. Commissioner*, 68 T.C. 563, 590 (1977), *acq.* 1979-1 C.B. 1. The good will purchased by *X* is clearly export related and is as essential to its sales operation as tangible assets used in the sale or transportation of export property. Thus, the good will purchased by *X* is a qualified export asset under section 993(b)(2), similar to tangible assets owned by a DISC that are used primarily in connection with the sale, etc., of export property.

HOLDING

The good will acquired by *X* in connection with the purchase of the assets of *Z* is a qualified export asset under section 993(b)(2) of the Code.

---

26 CFR 1.993-7: Definition of United States.

Export property; manufacture in U.S. foreign trade zone. Goods manufactured in a U.S. foreign trade zone by a domestic corporation are manufactured in the U.S. within the meaning of section 993(c)(1)(A) of the Code.

Rev. Rul. 82-115

ISSUE

Is property manufactured in the United States within the meaning of section 993(c)(1)(A) of the Internal Revenue Code when it is manufactured in a foreign trade zone (*FTZ*)?

FACTS

P, a domestic corporation, is engaged in the manufacture of goods. *P* has a wholly-owned domestic subsidiary, *S*, that is a Domestic International Sales Corporation (*DISC*). *P* entered into an agreement with *S* whereby *S* was granted a franchise with respect to export sales of the goods manufactured by *P*.

P's factory is within an *FTZ* that is adjacent to a port of entry inside the United States. *P* imports to its factory articles from foreign countries used in its manufacturing process. *P* adds American-made articles to the imports and converts them into finished goods. Not more than 50 percent of the fair market value of the finished goods is attributable to the imported articles. *P*'s conversion costs (direct labor and factory burden including packaging or assembly) with respect to the finished goods account for 20 percent of *P*'s cost of goods sold. All activity regarding P's manufacture of the goods takes place within the *FTZ*.

Under the franchise agreement with *S*, *P* sells the goods to *S* and *S* resells them directly from the *FTZ* to unrelated customers for direct use outside the United States.

LAW AND ANALYSIS

Section 992(a)(1)(A) of the Code provides, in part, that 95 percent or more of the gross receipts of a *DISC* must consist of "qualified export receipts." Section 993(a)(1)(A) provides, in part, that qualified export receipts include gross receipts from the sale of "export property." Section 993(c)(1) provides, in part, that export property means property (A) manufactured in the United States by a person other than a *DISC*, (B) held primarily for sale in the ordinary course of a trade or business by or to a *DISC* for direct use outside the United States, and (C) not more than 50 percent of the fair market value of which is attributable to imported articles.

Section 7701(a)(9) of the Code provides that the term "United States" when used in a geographical sense includes only the States and the District of Columbia. Section 993(g) provides that for purposes of the *DISC* provisions of the Code (sections 991-997), the term "United States" includes the Commonwealth of Puerto Rico and the possessions of the United States.

The customs territory of the United States includes the States, the District of Columbia and the Commonwealth of Puerto Rico. 19 C.F.R. section 146.1(c)(1981). Pursuant to 19 U.S.C. section 81b.(a), an *FTZ* may be established in or adjacent to a port of entry under the jurisdiction of the United States. An *FTZ* is considered not to be within the customs territory of the United States; therefore, foreign merchandise may be imported into the *FTZ* and there manufactured and exported without being subject to United States custom laws. 19 C.F.R. section 146.1(c) (1981) and 19 U.S.C. section 81c.

Although *FTZ*s are located outside the United States customs territory by virtue of the federal statutes and regulations, *FTZ*s are located, geographically, within the United States as defined for purposes of section 993. By authorizing the creation of *FTZ*s for purposes of the United States customs laws, Congress did not intend that the *FTZ* would be excluded from the United States. The express intention of Congress was that only the United States customs laws be suspended within the *FTZ* and the courts have recognized and applied this intent. 78 Cong. Rec. 9852-9853 (1934); *G.D. Searle and Co. v. Byron Chemical Co.* 223 F. Supp. 172 (E.D. N.Y. 1963) (United States patent laws apply in an *FTZ*). See also Rev. Rul. 76-161, 1976-1 C.B. 193 (which holds that a foreign corporation is subject to United States income tax on income earned from sales made from its *FTZ* warehouse within the United States).

HOLDING

An *FTZ* is located within the geographic area of the United States, as defined by section 993(g) of the Code, and, therefore, property manufactured within an *FTZ* is property manufactured in the United States within the meaning of section 993(c)(1)(A).

Section 994.—Inter-Company Pricing Rules

26 CFR 1.994-1: Inter-company pricing rules for DISCs.
(Also Section 482; 1.482-1.)

Domestic international sales corporation; amended return; different inter-company pricing rule used. The Commissioner will accept the timely filed amended returns of a DISC and its parent in which the DISC recomputes its income under a rule described in section 994(a) of the Code, other than that applied in its original return, to determine the maximum allowable commission, and in which the parent makes the correlative adjustments.

Rev. Rul. 82-81

ISSUE

Will the Commissioner accept amended federal income tax returns of a DISC and its parent, filed after the expiration of the dates for filing the original returns but before the expiration of the statute of limitations, in which the DISC recomputes its income using a rule, described in section 994(a) of the Internal Revenue Code, other than that used in its original return, and in which the parent makes the correlative adjustments?

FACTS

P, a domestic corporation, organized *S*, a subsidiary that qualifies as a DISC. *P* pays a commission to *S* for the sale of export property. A written agreement between *P* and *S* provides that *S* will earn commissions equal to the maximum amount allowable under the intercompany pricing rules of section 994 of the Code.

For its tax years 1977 through 1979 *S* used the "section 482 rule" of section 994(a)(3) of the Code to compute its commission, believing that under that rule the maximum amount of permissible commission income would result. However, as a result of adjustments made during examination of those tax years by an Internal Revenue agent, the maximum permissible amount would have been derived if the "50-50 combined taxable income rule" described in section 994(a)(2) had been used. Both *P* and *S* filed amended federal income tax returns with the District Director having jurisdiction over the original returns. In its amended return *S* computed its commission income using the 50-50 combined taxable income rule. *P*, in its amended return, made the necessary correlative adjustments. The statute of limitations for *S*'s and *P*'s tax years under examination has not expired.

LAW

Section 994(a) of the Code provides that in the case of a sale of export property to a DISC by a person described in section 482 (related person), the taxable income of the DISC attributable to the sale will be an amount that does not exceed the greatest of the three rules described in section 994 (a)(1), (2), and (3). Section 1.994-1 of the Income Tax Regulations extends the application of the three rules in section 994(a) to determine the allowable commissions paid to a DISC.

Section 1.994-1(e)(4) of the regulations provides that the DISC and the related person ordinarily determine under section 994 of the Code the commission payable to the DISC for a transaction before the DISC files its return for the tax year of the transaction. After the DISC files its return, a redetermination of the commission may be made only if permitted by the Code and the relevant regulations.

ANALYSIS

The choice of an intercompany pricing rule under section 994(a) of the Code ordinarily is made before the DISC return for the tax year of the transaction is filed. Section 1.994-1(e)(4) of the regulations permits a redetermination of the commission in an amended return if otherwise permitted by the Code and regulations. Because the period of limitations has not expired for each of the tax years under examination for both *P* and *S*, there are no statutory or regulatory provisions to preclude *S* from changing to the intercompany pricing rule that will result in the maximum permissible amount. It is the intent of section 994(a) that the DISC and related person select the rule in section 994(a) that maximizes the DISC's taxable income for each transaction. If a rule is chosen in the mistaken belief that it will result in the maximum permissible commission, the ability to file an amended DISC return is necessary to effect that statutory intent. Section 1.994-1(e)(4) provides an opportunity for the DISC and related person to correct the mistake made in the original return. The fact that the DISC becomes aware of the erroneous choice independently, or as a result of audit adjustments, is not determinative.

HOLDING

The Commissioner will accept the timely filed amended returns of the DISC and its parent in which the DISC recomputes its income under a rule described in section 994(a) of the Code, other than that applied in its original return, to determine the maximum allowable commission, and in which the parent makes the correlative adjustments.

Subchapter O.—Gain or Loss on Disposition of Property
Part I.—Determination of Amount of and Recognition of Gain or Loss

---

Section 1001.—Determination of Amount of and Recognition of Gain or Loss

26 CFR 1.1001-1: Computation of gain or loss. (Also Sections 61, 162, 165, 212, 1033, 1231; 1.61-14, 1.162-18, 1.165-1, 1.212-1, 1.1033(a)-2, 1.1231-1.)

Receipt of insurance proceeds as result of arson. Insurance proceeds received by a taxpayer who pays a third party to burn down the taxpayer's building represents gain includible as ordinary income in the taxpayer's gross income. Other federal income tax consequences resulting from discovery of the arson and repayment of the insurance proceeds in the following tax year are also discussed.

Rev. Rul. 82-74

ISSUE

What are the federal income tax consequences to a taxpayer who pays a third party to burn down the taxpayer's building when the arson is not discovered until the next taxable year?

FACTS

Taxpayer, an individual, is the lessor of office space in a building taxpayer purchased in 1967. In 1980, the building had an adjusted basis in taxpayer's hands of 20*x* dollars and the land upon which it was situated had an adjusted basis of 7x dollars. Because of mounting losses on the building's operation and declining property values, taxpayer decided to burn down the building to collect the fire insurance proceeds. Taxpayer paid a third party 5*x* dollars to set a fire. After the fire, which totally destroyed the building, taxpayer collected 100*x* dollars under an insurance policy.

On taxpayer's federal income tax return for 1980, taxpayer reported a long term capital gain of 80*x* dollars (100*x* dollars insurance proceeds less 20*x* dollars adjusted basis of the building), and deducted the 5*x* dollars paid to the third party as a business expense. In 1981 the arson was discovered. The taxpayer was convicted and returned the 100*x* dollars to the insurance company.

Committing arson, paying another to commit arson, and making fraudulent insurance claims are illegal under applicable state laws. These laws are generally enforced and subject the violator to criminal penalties.

LAW AND ANALYSIS

Section 162(a) of the Internal Revenue Code allows a deduction for all ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business. Section 162(a)(2) disallows deductions under section 162(a) for payments that are illegal under any law of the United States or any state (if it is generally enforced) that subjects the payor to a criminal penalty.

Section 212 of the Code allows individual taxpayers a deduction for all ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income.

Section 1.212-1(p) of the Income Tax Regulations disallows deductions under section 212 of the Code if they relate to payments of a type for which a deduction would be disallowed under section 162(c), (f), or (g) and the regulations thereunder in the case of a business expense.

Section 165(a) of the Code allows a deduction for any loss sustained during the taxable year and not compensated for by insurance or otherwise. Such a deduction is allowed, under section 165(b), only to the extent of the taxpayer's adjusted basis as provided in section 1011 for determining the loss from the sale or other disposition of property. Section 165 (c) provides that in the case of an individual, the deduction under section 165(a) shall be limited to losses incurred in a trade or business; losses incurred in any transaction entered into for profit, though not connected with a trade or business; and, with certain limitations, casualty losses sustained during the taxable year and not compensated for by insurance.

Section 1.165-3(b) of the regulations provides that the loss incurred in a trade or business or a transaction entered into for profit and arising from a demolition of old buildings shall be allowed as a deduction under section 165(a) of the Code if the demolition occurs as a result of a plan formed subsequent to the acquisition of the buildings demolished. The amount of the loss shall be the adjusted basis of the buildings demolished increased by the net cost of demolition or decreased by the net proceeds from demolition.

Section 61(a)(3) of the Code provides that except as otherwise provided in subtitle A, gross income means all income from whatever source derived, including gains derived from dealings in property.

Section 1001(a) of the Code provides that gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

Section 1.1001-1(a) of the regulations provides that, except as otherwise provided in subtitle A of the Code, the gain or loss realized from the conversion of property into cash is treated as income or as loss sustained.

Section 1231 of the Code provides that if recognized gains on sales or exchanges or property used in the trade or business, plus recognized gains from involuntary conversions of property used in the trade or business and capital assets held for more than 1 year into other property or money, exceed the recognized losses from such sales, exchanges, or conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 1 year.

Section 162(c)(22) of the Code requires that the illegal payment of 5*x* dollars to the third party be disallowed as a deduction. Similarly, section 1.212-1(p) of the regulations would disallow a deduction for this payment under section 212.

With respect to the insurance proceeds received by taxpayer in 1980, if property as a result of its destruction in whole or in part is involuntarily converted into money (insurance proceeds) section 1033(a)(2) of the Code provides that any gain is recognizable except as otherwise provided therein. See *Central Tablet Mfg. Co. v. United States*, Civil No. 69-116 (S.D. Ohio 1975), indicating that under the predecessor to section 1033(a)(2), where the fire insurance proceeds exceed the taxpayer's adjusted basis in the destroyed property, this excess gain is realized and ordinarily recognized. In certain cases, such recognized gain from involuntary conversions is treated as gain from the sale or exchange of capital assets pursuant to section 1231(a).

Although the building in question was converted into money (insurance proceeds) as a result of its destruction, this conversion was not "involuntary" within the meaning of sections 1033 or 1231 of the Code. See Rev. Rul. 69-654, 1969-2 C.B. 162, providing that a conversion of property is not involuntary within the meaning of section 1033 where the property owner consents to the subsequent conversion of part of the property. Since the taxpayer here not only consented but intentionally pursued the destruction of the property, there was no involuntary conversion for purposes of section 1033.

Moreover, the receipt of the insurance proceeds by taxpayer as compensation for the loss of a building destroyed by the fire does not result in gain from a "sale or exchange" of a capital asset within the meaning of section 1231 of the Code. In *Helvering v. William Flaccus Oak Leather Co.*, 313 U.S. 247(1941), Ct.D. 1510, 1941-1 C.B. 324, the Supreme Court concluded, under a predecessor of section 1231 (which did not allow capital gains treatment for involuntary conversions compensated by insurance), that fire insurance proceeds received from an involuntary conversion did not result in gain from a "sale or exchange" of a capital asset. Consequently, the insurance proceeds received by the taxpayer in 1980 as a result of the destruction of property by arson represent gain from the disposition of property as determined under section 1001(a) and section 1.1001-1(a) of the regulations (excess of the amount realized over the adjusted basis) that is includible in gross income, under section 61(a)(3). This gain, 80*x* dollars (100*x* - 20*x*), is ordinary income to taxpayer, since the sale or exchange requirement for capital gains treatment has not been met.

In addition, taxpayer's basis in the destroyed property would be decreased to the extent of the proceeds received (but not less than zero) in 1980. See *C. G. Willis Inc. v. Commissioner*, 41 T.C. 468 (1964). Therefore, taxpayer's basis in the destroyed building would become zero in 1980.

Under section 1.165-3(b) of the regulations, assuming the destruction of the building occurred as a result of a plan formed subsequent to its acquisition, in computing the tax consequences from the fire the adjusted basis of taxpayer's building would ordinarily be increased by the net cost incurred with respect to the destruction of the property. However, since the allowance of an upward basis adjustment for the 5*x* dollars, which was paid by taxpayer to a third party to set the fire, would severely and immediately frustrate the statutory scheme regarding arson and insurance fraud in this case, such adjustment is precluded on public policy grounds. See Rev. Rul. 77-126, 1977-1 C.B. 47, which holds that although Congress codified and limited the public policy doctrine in the case of ordinary and necessary business expenses by amending section 162(c) of the Code and enacting sections 162(f) and (g), the rules for disallowing a deduction under section 165 on the grounds of public policy were not so limited.

Following repayment of the 100*x* dollars to the insurance company in 1981, taxpayer is entitled to a loss deduction pursuant to section 165 of the Code. See Rev. Rul. 65-254, 1965-2 C.B. 50, which holds that an individual who embezzled funds during 1959, 1960, and 1961 and repaid the total amount when the embezzlement was discovered in 1962 was entitled to a loss deduction under section 165 in 1962. Also, as indicated in Rev. Rul. 65-254, taxpayer is not entitled to the benefit of section 1341 (Computation of Tax Where Taxpayer Restores Substantial Amount Held Under Claim of Right) with respect to the repayment of the fraudulently obtained funds, as the proceeds of arson are not received under a claim of right. See *McKinney v. United States*, 574 F. 2d 1240 (5th Cir. 1978).

Upon making restitution to the insurance company in 1981, taxpayer will sustain a loss for tax purposes. Taxpayer's loss deduction will be limited to 80*x* dollars, the amount previously included in gross income. Because the building was destroyed in a transaction for which a deduction is not allowable under any provision of the Code, the taxpayer's basis in the building is not restored and remains at zero, and no part of the basis is allocable to the land. See Rev. Rul. 81-24, 1981-1 C.B. 79.

HOLDING

The federal income tax consequences to a taxpayer that pays a third party to burn down the taxpayer's building, under the facts presented above, are as follows: (1) any business deduction claimed for payments to an arsonist is disallowed; (2) any gain realized upon payment of fire insurance proceeds is ordinary income and not capital gain; (3) taxpayer's basis in the building is reduced to zero upon receipt of the proceeds; (4) taxpayer's basis shall not be increased by any costs incurred to destroy the building (assuming the building was destroyed as a result of a plan formed subsequent to its acquisition); and (5) upon repayment of the proceeds to the insurer, taxpayer's adjusted basis in the building remains at zero, no part of the basis is allocable to the land, and a loss deduction is allowed for the insurance proceeds repaid to the insurer to the extent the proceeds were previously included in gross income.

See Rev. Rul. 81-24, for federal income tax consequences to a taxpayer who burns down his own building but the insurance proceeds are not paid because the arson is discovered.

Part II.—Basis Rules of General Application

Section 1023.—Carryover Basis for Certain Property Acquired from a Decedent

26 CFR 7.1023(b)(3)-1: Exclusion of certain personal and household effects from carryover basis treatment.

T.D. 7805 [1]

TITLE 26—INTERNAL
REVENUE—CHAPTER I,
SUBCHAPTER A, PART
1—INCOME TAX; PART
7—TEMPORARY INCOME TAX
REGULATIONS UNDER THE TAX
REFORM ACT OF 1976

The use of property that has been valued under section 2032A to satisfy a pecuniary bequest (withdrawal of portion of notice of proposed rulemaking); deletion of certain carryover basis rules.

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document withdraws a portion of a notice of proposed rulemaking relating to the use of property that has been valued under section 2032A to satisfy a pecuniary bequest and adopts that portion of the same notice of proposed rulemaking relating to the deletion of certain carryover basis rules.

DATE: This document is effective immediately upon its publication in the Federal Register.

FOR FURTHER INFORMATION CONTACT: Stephen J. Small of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Ave. N.W., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3238, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On May 28, 1981, proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 1040 of the Internal Revenue Code of 1954 (Code) were published in the Federal Register [LR-214-76, 1981-1 C.B. 768] (46 FR 28677). These amendments were proposed to conform the regulations to section 401(c)(2)(A) of the Crude Oil Windfall Profit Tax Act of 1980 (94 Stat. 300) [Pub. L. 96-223, 1980-3 C.B. 1, 72] which provided rules relating to the use of property that is valued under section 2032A to satisfy a pecuniary bequest.

The notice of proposed rulemaking also proposed to delete the temporary regulations found at §§7.1023(b)(3)-1 and 7.1023(h)-1 (26 CFR Part 7). These temporary regulations were deleted rather than revoked because they continue to be applicable for the estates of certain decedents whose executors or administrators elected carryover basis treatment for assets acquired or passing from decedents by filing Form 5970-A, Election of Carryover Basis.

Section 421(j)(2)(B) of the Economic Recovery Tax Act of 1981 (92 Stat. 312) [Pub. L. 97-34, 1981-2 C.B. 256, 327] amended retroactively section 1040 of the Code in such a substantive way by removing the restrictions relating to pecuniary bequests that the relevant portion of the notice of proposed rulemaking is no longer viable and must be withdrawn. The Internal Revenue Service anticipates issuing a new notice of proposed rulemaking under section 1040.

However, the deletion of the temporary carryover basis regulations remains appropriate, and that portion of the notice of proposed rulemaking is adopted by this Treasury decision.

The only comments received related to the portion of the notice that is being withdrawn. There was no request for a public hearing.

DRAFTING INFORMATION

The principal author of this regulation is Stephen J. Small of the Legislation and Regulations Division, Office of the Chief Counsel, 1111 Constitution Avenue, N.W., Washington, D.C. However, personnel from other offices of the Internal Revenue Service and the Treasury Department participated in developing the regulation, both on matters of substance and style.

ADOPTION OF AMENDMENTS TO THE REGULATIONS

Accordingly, the amendments to the Income Tax Regulations (26 CFR Part 1) as proposed in paragraph 1 of the Notice of Proposed Rulemaking published on May 28, 1981 (46 FR 28677) are hereby withdrawn, and the amendments to the Temporary Income Tax Regulations under the Tax Reform Act of 1976 as proposed in paragraph 2 of that notice are hereby adopted as follows.

Paragraph 1. Proposed new §1.1040-1 is withdrawn.

Par. 2. §7.1023(b)(3)-1 Exclusion of certain personal and household effects from carryover basis treatment. [Deleted but not revoked.]

§7.1023(h)-1 Adjustment to basis of marketable bonds and securities acquired from a decedent dying after December 31, 1976, for appreciation occurring before January 1, 1977.

---

[1] The instructions for modifying the notice of proposed rulemaking have been omitted.

[Deleted but not revoked.]

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

ROSCOE L. EGGER, JR.,
Commissioner of
Internal Revenue

Approved January 13, 1982.

JOHN E. CHAPOTON,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on February 1, 1982, 8:45 a.m., and published in the issue of the Federal Register for February 2, 1982, 47 F.R. 4681)

Part III.—Common Nontaxable Exchanges

Section 1031.—Exchange of Property Held for Productive Use or Investment

26 CFR 1.1031(a)-1: Property held for productive use in trade or business or for investment.

Sales or exchanges; like kind; gold bullion for gold coins. The exchange of gold bullion for Canadian Maple Leaf gold coins qualifies for nonrecognition of gain or loss as a like kind exchange under section 1031(a) of the Code.

Rev. Rul. 82-96

ISSUE

Does the exchange of gold bullion for Canadian Maple Leaf gold coins qualify for nonrecognition of gain or loss under section 1031 of the Internal Revenue Code?

FACTS

An individual taxpayer, who is not a dealer in gold bullion or coins, purchased gold bullion in the cash market and held it as an investment. The taxpayer subsequently exchanged the gold bullion for Canadian Maple Leaf gold coins, which also were held for investment. On the date of the exchange, the total fair market value of the gold bullion was equal to the total fair market value of the Canadian Maple Leaf gold coins.

The Canadian Maple Leaf gold coin is legal tender in Canada. However, the gold content of each coin greatly exceeds its face amount of $50. The Canadian Maple Leaf gold coin has no numismatic value.

LAW AND ANALYSIS

Section 1031(a) of the Code provides that no gain or loss is recognized upon an exchange of property held for productive use in trade or business or for investment solely for property of a like kind to be held either for productive use in trade or business or for investment.

Section 1.1031(a)-1(b) of the Income Tax Regulations provides that as used in section 1031(a) of the Code, the words "like kind" have reference to the nature or character of the property and not its grade or quality. One kind or class of property may not, under that section, be exchanged for property of a different kind or class.

Section 1031(b) of the Code provides that if an exchange would be within the provisions of section 1031(a) if it were not for the fact that the property received in exchange consists not only of property permitted by such provisions to be received without recognition of gain, but also of other property or money, then the gain, if any, to the recipient will be recognized, but in an amount not in excess of the sum of the money and the fair market value of the other property.

Section 1031(c) of the Code provides that if an exchange would be within the provisions of section 1031(a) if it were not for the fact that the property received in exchange consists not only of property permitted by such provisions to be received without recognition of gain or loss, but also of other property or money, then no loss from the exchange will be recognized.

In Rev. Rul. 74-218, 1974-1 C.B. 202, currency, in its usual and ordinary acceptation, is defined as gold, silver, other metals, or paper used as a circulating medium of exchange.

Rev. Rul. 76-214, 1976-1 C.B. 218, holds that the exchange of Mexican 50-peso bullion-type gold coins for Austrian 100-corona bullion-type gold coins qualifies for nonrecognition of gain under the provisions of section 1031(a) of the Code. The gold coins described in Rev. Rul. 76-214 were restrikes and were not circulating mediums of exchange in their respective countries and, therefore, were not currency, or money as that term is used in section 1031 of the Code.

In Rev. Rul. 76-249, 1976-2 C.B. 21, a taxpayer exchanged real property with a fair market value of $6,000 for United States silver coins with a face value of $2,000 and a fair market value of $6,000. The revenue ruling holds that silver coins received for the real property are to be treated as property and not as money. Therefore, the amount realized by the taxpayer from the exchange was the fair market value of the silver coins ($6,000) rather than the face amount of the coins ($2,000).

Rev. Rul. 79-143, 1979-1 C.B. 264, holds that the exchange of United States $20 gold coins (numismatic-type coins) for South African Krugerrand gold coins (bullion-type coins) does not qualify for nonrecognition of gain under section 1031(a) of the Code because the numismatic-type coins and the bullion-type coins are not property of like kind.

In the present case the taxpayer exchanged gold bullion for Canadian Maple Leaf gold coins, which are legal tender in Canada to the extent of their face value of $50 each. However, because the value of the gold content in each Canadian Maple Leaf gold coin greatly exceeds its face value, it is not a circulating medium of exchange. Therefore, the Canadian Maple Leaf gold coin is property rather than money for purposes of section 1031(a) of the Code. See Rev. Rul. 76-214 and compare Rev. Rul. 76-249.

Because the Canadian Maple Leaf gold coins are bought and sold for their gold content, they are bullion-type coins. Therefore, the nature and character of the gold bullion and the Canadian Maple Leaf gold coins are the same, and they qualify as "like kind" property as that term is used in section 1.1031(a)-1(b) of the regulations.

HOLDING

The taxpayer's exchange of gold

bullion for Canadian Maple Leaf gold coins qualifies for nonrecognition of gain or loss under section 1031(a) of the Code.

Section 1033.—Involuntary Conversions

26 CFR 1.1033(a)-1: Involuntary conversions, nonrecognition of gain.
(Also Section 1071; 1.1071-1.)

Involuntary conversions; exchange to effectuate policies of F.C.C.; similar property. Acquisition of stock in a corporation solely engaged in the operation of a radio broadcasting station and stock of a corporation primarily (but not solely) engaged in the operation of a radio broadcasting station by a taxpayer holding a "tax certificate", issued under section 1071 of the Code, qualifies for treatment under section 1033.

Rev. Rul. 82-70

ISSUE

Will the acquisition of stock in a corporation solely engaged in the operation of a radio broadcasting station and stock of a corporation primarily (but not solely) engaged in the operation of a radio broadcasting station by a taxpayer holding a "tax certificate" issued under the provisions of section 1071 of the Internal Revenue Code qualify for treatment under section 1033 under the circumstances described below?

FACTS

A, an individual, owns stock of *X*, a domestic corporation operating a radio broadcasting station, and in 1980 sold the stock of *X* to *B*. The Federal Communications Commission (FCC) granted *A* a certificate that clearly identified the property and showed that the sale to *B* was necessary or appropriate to effect a change in a policy of, or the adoption of a new policy by, the FCC with respect to the ownership and control of radio broadcasting stations. *A* realized a gain on the sale.

A elected to treat the sale of *X* stock as an involuntary conversion under section 1033 of the Code, and, within the time prescribed by section 1033(a)(2)(B), purchased stock in corporations *Y* and *Z*. *Y* is solely engaged in the radio broadcasting business while *Z* is primarily engaged in the radio broadcasting business but also carries on other activities not related to radio broadcasting.

LAW AND ANALYSIS

Section 1033(a) of the Code provides that if property is involuntarily converted into money and the taxpayer, during the period specified, purchases other property similar or related in service or use to the property so converted, at the election of the taxpayer the gain shall be recognized only to the extent that the amount realized upon such conversion exceeds the cost of such other property. As a general rule the converted property must be replaced before the expiration of 2 years after the close of the first taxable year in which any part of the gain upon conversion is realized.

Section 1071(a) of the Code provides that if the sale of property (including stock in a corporation) is certified by the FCC to be necessary or appropriate to effect a change in the policy of, or the adoption of a new policy by, the FCC with respect to ownership and control of radio broadcasting stations upon election by the taxpayer, the sale shall be treated as an involuntary conversion within the meaning of section 1033. For purposes of section 1033, as made applicable by the provisions of section 1071, stock of a corporation operating a radio broadcasting station, whether or not representing control of such corporation, shall be treated as property similar or related in service or use to the property so converted.

Section 1.1071-2(b)(1) of the Income Tax Regulations provides that for purposes of section 1071 of the Code and the regulations thereunder, stock of a corporation operating a radio broadcasting station shall be treated as property similar or related in service or use to the property sold or exchanged. Securities of such a corporation other than stock, or securities of a corporation not operating a radio broadcasting station, do not constitute property similar or related in service or use to the property sold or exchanged.

Section 1071 of the Code and regulations thereunder provide that stock of a corporation operating a radio broadcasting station shall be treated as property similar or related in service or use to the property sold or exchanged. Moreover, section 1071 and the regulations thereunder do not require that such a corporation be solely engaged in the business of operating a radio broadcasting station. Consequently, stock in a corporation engaged either solely or primarily in the business of operating a radio broadcasting station qualifies as property similar or related in service or use to the property sold or exchanged.

HOLDING

The acquisition of stock in a corporation solely engaged in the operation of a radio broadcasting station and stock of a corporation primarily (but not solely) engaged in the operation of a radio broadcasting station by a taxpayer holding a "tax certificate" issued under the provisions of section 1071 of the Code, qualifies for treatment under section 1033.

---

26 CFR 1.1033(a)-2: Involuntary conversion into similar property, into money or into dissimilar property.

Whether destruction of the taxpayer's building as a result of the taxpayer's arson is an involuntary conversion within the meaning of section 1033 of the Code. See Rev. Rul. 82-74, page 110.

Section 1034.—Rollover of Gain on Sale of Principal Residence

26 CFR 1.1034-1: Sale or exchange of residence.
(Also Section 280A.)

Residence; business use; limitations on deferral of gain. The part of the gain on the sale of a personal residence that is allocable to the part of the residence used in the taxpayer's trade or business may not be deferred under section 1034 of the Code if the business use met the requirements of section 280A(c)(1) in the year of sale. However, no allocation is required if the business use of a part of a residence in the year of sale does not meet the requirements of section 280A(c)(1).

Rev. Rul. 82-26

ISSUE

Under the circumstances described below, is gain recognized under section 1034 of the Internal Revenue Code on the sale of a principal residence when a part of the residence was used for business purposes?

FACTS

Situation 1: In January 1976, *A*, a 39 year old individual, purchased a used home for 70x dollars. This home was used as *A*'s principal residence. *A* used a part of the home exclusively on a regular basis to see patients in connection with *A*'s occupation as a doctor. With regard to such use, *A* claimed, and was allowed, in each taxable year a business deduction. In December 1981, *A* sold the home; the adjusted sale price was 120x dollars. Also in December 1981, *A* purchased for 140x dollars a new home. No part of the new home was used in connection with *A*'s trade or business; that is, the home was used exclusively as a principal residence by *A*.

Situation 2: In 1970 *B*, a 39 year old individual, purchased a used home for 40x dollars. This home was used as *B*'s principal residence. *B* also used a part of the home as an office in connection with *B*'s occupation as a school teacher.

In connection with *B*'s occupation, *B* claimed a deduction under section 162 of the Code with regard to an office in the home for the years 1971 through 1975. The deductions were allowed based on a 25-percent use of the home for business purposes. However, for 1976 and subsequent years, deductions were not allowable because of section 280A, which became effective for taxable years beginning after December 31, 1975. However, *B* continued to use the home office in connection with *B*'s business. In November 1981, *B* sold the home, and the adjusted sales price was 80x dollars. Also in November 1981, *B* purchased for 90x dollars a new home. That home was used exclusively by *B* as a principal residence, no part of which was used in connection with *B*'s trade or business so as to qualify for a deduction under section 280A(c)(1).

LAW AND ANALYSIS

Section 1034 of the Code provides that if a taxpayer sells property (the "old residence") used by the taxpayer as a principal residence and, within a period beginning 2 years before the date of such sale and ending 2 years after such date, property (the "new residence") is purchased and used by the taxpayer as a principal residence, gain (if any) from such sale shall be recognized only to the extent that the taxpayer's adjusted sales price of the old residence exceeds the taxpayer's cost of purchasing the new residence. (Generally, for "old residences" sold or exchanged before January 20, 1980, the 2-year periods are 18 months.)

Section 1.1034-1(c)(3)(ii) of the Income Tax Regulations provides that where part of a property is used by the taxpayer as a principal residence and part is used for other purposes, an allocation must be made to determine the application of section 1034 of the Code. If the old residence is used only partially for residential purposes, only that part of the gain allocable to the residential portion is not to be recognized under section 1034. Also, only an amount allocable to the selling price of such portion need be reinvested in the new residence in order to have the gain allocable to such portion not recognized under section 1034.

Section 280A(a) of the Code provides that in the case of an individual taxpayer no deduction otherwise allowable shall be allowed with respect to the use of a dwelling unit that is used by the taxpayer during the taxable year as a residence, except as otherwise provided in section 280A.

Section 280A(c)(1) of the Code provides that subsection (a) shall not apply to any item to the extent the item is allocable to a portion of the dwelling unit that is used exclusively on a regular basis (A) as the taxpayer's principal place of business; (B) as a place of business that is used by patients, clients, or customers in meeting or dealing with the taxpayer in the normal course of the taxpayer's trade or business; or (C) in the case of a separate structure that is not attached to the dwelling unit, in connection with the taxpayer's trade or business.

Rev. Rul. 59-72, 1959-1 C.B. 203, holds that where all the facts and circumstances indicate that property sold by a taxpayer was used by the taxpayer as the taxpayer's principal residence, the taxpayer will be entitled to relief provided for by section 1034 of the Code, notwithstanding the fact that the taxpayer temporarily rented out the residence prior to its sale. Thus, the Service looks to the use of the property at the time of sale.

When part of a property is used as a principal residence and part is used, until it is sold, for business, nonrecognition of gain under section 1034 of the Code is limited to the gain realized on that part of the property used as a residence. Although not every use of a principal residence in connection with a taxpayer's trade or business will limit the application of section 1034, when the taxpayer uses the residence in a trade or business in the manner and to the extent prescribed by section 280A(c)(1), there is a business use of a part of the property within the meaning of section 1.1034-1(c)(3)(ii) of the regulations. Thus, any gain on the sale must be allocated between the business and residential parts of the property.

In *Situation 1*, a part of *A*'s residence was used in connection with *A*'s medical practice until it was sold. The part of the home that was used in connection with *A*'s occupation as a doctor was used exclusively on a regular basis as an office in which *A* met with patients in the normal course of the medical practice. Thus, the requirements of section 280A(c)(1) of the Code were satisfied and deductions were allowed with respect to the business use of the residence. Because the criteria of section 280A(c)(1) were met, *A* must make the allocation required by section 1.1034-1(c)(3)(ii) of the regulations.

The fact that a taxpayer was allowed business expense deductions for the use of a residence prior to 1976 does not mean that an allocation is required under section 1.1034-1(c)(3)(ii) of the regulations. Not every use of a residence in connection with a taxpayer's trade or business necessitates an allocation. When such use does not meet the standards of section 280A(c)(1) of the Code, the taxpayer is not considered to have used a part of the property for business purposes within the meaning of section 1.1034-1(c)(3)(ii).

In *Situation 2*, for the taxable years 1971 through 1975, *B* was allowed deductions under section 162 of the Code for the part of the home used as an office in connection with *B*'s occupation as a teacher. However, after the effective date of section 280A, section 162 deductions were not allowed to *B* for the part of the home used in connection with *B*'s occupation as a teacher, and *B*'s use of the residence did not meet the standards of section 280A(c)(1) of the Code.

HOLDINGS

In *Situation 1*, *A* must make the allocation required under section 1.1034-1(c)(3)(ii) of the regulations, and may defer under section 1034 of the Code only that part of the gain on the sale of the residence that is allocable to the residential portion of the property.

In *Situation 2*, *B* is not required to make any allocation of the gain on the sale of the residence under section 1.1034-1(c)(3)(ii) of the regulations and may defer under section 1034 of the Code the entire gain on the sale of the residence.

Part V.—Changes to Effectuate F.C.C. Policy

Section 1071.—Gain From Sale or Exchange to Effectuate Policies of F.C.C.

26 CFR 1.1071-1: Gain from sale or exchange to effectuate policies of Federal Communications Commission.

Whether the acquisition of stock in a corporation primarily (but not solely) engaged in the radio broadcasting business is property similar or related in services for purposes of section 1033 of the Code. See Rev. Rul. 82-70, page 114.

Subchapter P.—Capital Gains and Losses
Part III.—General Rules for Determining Capital Gains and Losses

---

Section 1221.—Capital Asset Defined

26 CFR 1.1221-1: Meaning of terms.

Whether a taxpayer is entitled to a charitable contribution deduction for the contribution of well cuttings, scout tickets, and electrical well logs. See Rev. Rul. 82-9, page 39.

Section 1223.—Holding Period of Property

26 CFR 1.1223-1: Determination of period for which capital assets are held.
(Also Sections 401, 402; 1.401-1, 1.402(a)-1.)

Holding period; common stock; profit-sharing plan. The holding period of common stock withdrawn by a taxpayer from a contributory profit-sharing plan qualified under section 401(a) of the Code begins on the date following the date the plan trustee delivered the stock to the transfer agent with instructions to reissue the stock in the taxpayer's name.

Rev. Rul. 82-75

ISSUE

When does the holding period begin for corporate stock distributed by a profit-sharing plan to a participant?

FACTS

Corporation *X* adopted a contributory profit-sharing plan that is qualified under section 401(a) of the Internal Revenue Code. The plan's related trust is exempt from tax under section 501(a). Under the plan, a participant may contribute a certain percentage of compensation and *X* will match the participant's contribution. Additional contributions may be made by the participant but *X* will not match those contributions. The contributions to the plan may be allocated by the participant between shares of *X* common stock and an income fund. The stock certificates are held in the trustee's name. After an amount is in the plan for 2 years, a participant may withdraw cash or stock from the accounts upon retirement, disability, occurrence of a hardship, or written demand to the trustee. Cash or stock may also be withdrawn upon the participant's death.

A, a participant in *X*'s plan, requested that shares of *X* stock be withdrawn from *A*'s stock account. In response to *A*'s request, the plan trustee delivered shares of *X* common stock to the transfer agent and instructed the agent to reissue the shares in *A*'s name. *A* subsequently received the stock certificates.

LAW AND ANALYSIS

Rev. Rul. 81-158, 1981-1 C.B. 205, holds that, for purposes of section 402 of the Code, a cash-method taxpayer receives a distribution from a stock bonus plan when the trustee delivers stock certificates to the transfer agent with instructions to reissue them in the name of the distributee. Rev. Rul. 81-158 also holds that a distribution from a profit sharing plan occurs upon delivery to a transfer agent of an order to cancel a "confirmation" representing shares owned by the bank custodian and to reissue them in the name of the distributee.

Rev. Rul. 54-607, 1954-2 C.B. 177, holds that, in determining the holding period of property for capital gain or loss purposes, the date the property is acquired is excluded and the date the property is disposed of is included.

For purposes of section 402 of the Code, *A* is considered to have received the distribution of the shares of *X* stock on the date the plan trustee delivered the stock to the transfer agent with instructions to reissue the stock in *A*'s name. See Rev. Rul. 81-158. However, in determining the holding period for the shares of *X* stock received by *A*, the date the property was acquired is excluded. See Rev. Rul. 54-607.

HOLDING

A's holding period for the shares of *X* stock begins on the date following the date the plan trustee delivered the stock to the transfer agent with instructions to reissue the stock in *A*'s name.

Part IV.—Special Rules for Determining Capital Gains and Losses

Section 1231.—Property used in the Trade or Business and Involuntary Conversions

26 CFR 1.1231-1: Gains and losses from the sale or exchange of certain property used in the trade or business.

Whether a taxpayer is entitled to a charitable contribution deduction for the contribution of well cuttings, scout tickets, and electrical well logs. See Rev. Rul. 82-9, page 39.

26 CFR 1.1231-1: Gains and losses from the sale or exchange of certain property used in the trade or business.

Whether insurance proceeds received as compensation for the loss of a building destroyed by arson represent gain from a sale or exchange of a capital asset within the meaning of section 1231 of the Code. See Rev. Rul. 82-74, page 110.

Subchapter T.—Cooperatives and Their Patrons
Part I.—Tax Treatment of Cooperatives

Section 1381.—Organizations To Which Part Applies

26 CFR 1.1381-1: Organizations to which part applies.
(Also Section 1382; 1.1382-1.)

Cooperative; integrated poultry operation. A nonexempt cooperative engaged in an integrated poultry operation that is indistinguishable from the normal operation of a corporation doing business for profit is not operating on a cooperative basis within the meaning of section 1381(a)(2) of the Code and is subject to tax at the corporation level on amounts returned to its shareholder-members according to their marketing agreement.

Rev. Rul. 82-51

ISSUES

1. Is the taxpayer described below operating on a cooperative basis within the meaning of section 1381(a)(2) of the Internal Revenue Code?

2. Must the taxpayer include in gross income any amounts returned to its members according to their marketing agreement?

FACTS

The taxpayer is a corporation engaged in an integrated poultry operation. The taxpayer, organized to function as a nonexempt cooperative, was established by seven individuals who merged and consolidated their poultry production activities. The seven individuals received common stock in exchange for their farming assets. As a result of this exchange, the shareholders no longer directly engaged in the active conduct of poultry operations with regard to functions being carried on by the taxpayer.

The taxpayer owns a breeder flock from which it sells chicks to its shareholder-members in proportion to their stock ownership. Only shareholders may be members of the cooperative and only members may purchase the chicks. The taxpayer retains a security interest in the flocks sold and uses personal recourse notes received as payment from its members as security for bank loans and operating funds.

When the chicks are sold, they are segregated and identified according to the member who has legal title to them. The taxpayer delivers the chicks to independent contract growers who have contracts with the individual members. These contracts are negotiated by the taxpayer, which also supervises and pays the contract growers.

The feed, medicine, and fees provided by the taxpayer to the contract growers are charged to the members' accounts. The taxpayer operates this supply function at cost.

At the end of the grow out period, the taxpayer repurchases the chickens from the members at a price equal to the current market quotation. The taxpayer receives the chickens from the contract growers and processes them for their final sale. Until the chickens are delivered to the taxpayer, the risk of loss, according to the marketing agreement, remains with the member who purchased the chicks.

After the taxpayer markets the chickens, the member receives a settlement sheet showing the total sales price. This figure is offset by the amount of advances recorded on the taxpayer's books as having been made to members for their particular flock. The taxpayer's method of operation usually results in a small profit or loss over the settlement sheet amounts determined during the year. Losses are allocated on a patronage basis to members and are used to offset any profits in the next grow out period. Profits are allocated by the taxpayer on its books and are used to offset advances to the members in the next grow out period. The taxpayer has never declared or paid a patronage dividend to its members.

LAW AND ANALYSIS

Section 1381(a)(2) of the Code provides that subchapter T applies to any corporation operating on a cooperative basis, with certain enumerated exceptions.

Section 1382(a) of the Code provides that, except as provided in section 1382(b), the gross income of any organization to which this part applies is determined without any adjustment by reason of any allocation or distribution to a patron out of the net earnings of the organization or by reason of any amount paid to a patron as a per-unit retain allocation.

Section 1382(b) of the Code provides that patronage dividends, as defined in section 1388(a), paid during the payment period for the tax year are not taken into account in determining taxable income.

Section 1388(a) of the Code defines a patronage dividend as an amount paid to a patron: (1) on the basis of the quantity or value of business done with or for the patron; (2) under an obligation of the organization to pay such an amount, the obligation having existed before the organization received the amount so paid; and (3) that is determined by reference to the net earnings of the organization from business done with or for its patrons. A patronage dividend does not include any amount paid to the patron to the extent (A) such an amount is out of earnings other than from business done with or for patrons, or (B) such an amount is out of earnings from business done with or for patrons to whom no amounts are paid, or to whom smaller amounts are paid with respect to substantially identical transactions.

Section 1.1388-1(e) of the Income

Tax Regulations states that the term "patron" includes any person with whom or for whom the cooperative association does business on a cooperative basis, whether a member or a nonmember of the cooperative association.

In *Mississippi Valley Portland Cement Company v. United States*, 408 F.2d 827 (5th Cir. 1969), the court denied a purported cooperative a deduction from its corporate income tax for patronage dividends. The taxpayer's method of doing business was indistinguishable from the normal corporation doing business for profit, even though the taxpayer was called a cooperative, and the dividends were referred to as patronage rebates. The payments were in reality no more than dividends paid to the taxpayer's shareholders, who were no more than paper patrons. The shareholders never had any actual contact with the cement sold by the cooperative. Therefore, the taxpayer's distribution did not result from business done with or for patrons.

In determining whether a distribution is made out of the earnings from business done with or for patrons, the court in *Mississippi Valley* noted that in most bona fide cooperative arrangements the patron does in some manner actually touch the subject matter of the transaction. Thus, evidence that the patron actually used or produced the commodities points logically to the conclusion that the business was conducted with or for this patron. Conversely, the absence of this type of evidence would support a conclusion to the contrary.

The court in *Mississippi Valley*, in reaching the conclusion that the taxpayer's shareholders were no more than paper patrons and that the distributions to its shareholders were nothing more than a dividend paid out of profits of the corporation, indicated that the shareholders were nonessential links in a conduit to the outside, not customers of the corporation, and that the distributions to these shareholders represented profits from corporate dealings with the general public and should be taxed accordingly.

Although in the present situation the member-stockholders were all involved in poultry production prior to the formation of the taxpayer, whereas in *Mississippi Valley* the member-stockholders came from diverse occupations and professions, the two cases are otherwise similar. The taxpayer initially owns the chicks that are sold to its members who are also shareholders. Although legal title to the chicks belongs to these member-shareholders, the sales transaction lacks economic substance. The member-shareholders take no action with respect to the chicks. Rather, it is the taxpayer who contracts and supervises the growth of the chicks done by the contract growers. The taxpayer even provides the necessary supplies to the contract growers. In addition, the taxpayer handles the subsequent sale of the chickens. The functions performed by the taxpayer are consistent with a corporation-shareholder relationship but not consistent with a cooperative-patron relationship. There is no business or economic reason to sell the chicks to the member-shareholders other than to try to secure for the member-shareholders the status of a patron. The member-shareholders are nonessential links to the outside and not consumers of the corporate products. In reality, the taxpayer's method of doing business is indistinguishable from the normal corporation doing business for profit, even though the taxpayer calls itself a cooperative. Any distributions to the member-shareholders are merely dividends paid to its shareholders.

HOLDING

1. The taxpayer described above is not operating on a cooperative basis within the meaning of section 1381 (a)(2) of the Code.

2. The taxpayer is subject to tax at the corporate level on any amounts returned to its members according to their marketing agreement.

Section 1382.—Taxable Income of Cooperatives

26 CFR 1.1382-1: Taxable income of cooperatives; gross income.

Whether the taxpayer, a corporation engaged in an integrated poultry operation, is operating on a cooperative basis within the meaning of section 1381(a)(2) of the Code or must the taxpayer include in gross income any amounts returned to its members according to their marketing agreement. See Rev. Rul. 82-51, page 117.

---

26 CFR 1.1382-2: Taxable income of cooperatives; treatment of patronage dividends.

Whether a nonexempt farmer's cooperative must allocate to both its patronage and nonpatronage sourced income a tax imposed by a state on all of the cooperative's net income in computing the amount available for distribution as patronage dividends under section 1388 of the Code. See Rev. Rul. 82-76, below.

Part III.—Definitions; Special Rules

Section 1388.—Definitions; Special Rules

26 CFR 1.1388-1: Definitions and special rules. (Also Section 1382; 1.1382-2.)

Nonexempt cooperative; patronage dividend. The state business and corporation privilege tax paid by a nonexempt cooperative must be allocated to both its patronage and nonpatronage sourced income before computing the amount available for distribution as patronage dividends under section 1388 of the Code. Rev. Rul. 74-161 distinguished.

Rev. Rul. 82-76

ISSUE

Must a nonexempt farmers' cooperative allocate to both its patronage and nonpatronage sourced income a tax imposed by a state on all of the cooperative's net income in computing the amount available for distribution as patronage dividends under section 1388 of the Internal Revenue Code?

FACTS

The taxpayer, a nonexempt cooperative within the meaning of section 1381(a)(2) of the Code, had income from both patronage and nonpatronage sources during the tax year. The taxpayer is subject to a business and corporation privilege tax imposed by State *X* on the net income derived from the operation of its business. For purposes of this tax, the net income of a cooperative includes distributed patronage dividends, amounts allocated to patrons but withheld, and amounts earned but not allocated by the cooperative. Federal income taxes paid or accrued are not deducted from net income for purposes of computing this tax.

For its 1980 tax year, the taxpayer computed the business and corporation privilege tax imposed by State *X*. The total amount of this tax was allocated by the taxpayer to its nonpatronage sourced income for federal income tax purposes. Therefore, patronage sourced income for 1980 that was available for distribution as patronage dividends was unreduced by the tax imposed by State *X* for the privilege of doing business in that state.

LAW AND ANALYSIS

Section 1382(a) of the Code provides that, except as provided in section 1382(b), the gross income of any organization to which this part applies is determined without any adjustment by reason of any allocation or distribution to a patron out of the net earnings of the organization or by reason of any amount paid to a patron as a per-unit retain allocation.

Section 1382(b) of the Code provides that patronage dividends, as defined in section 1388(a), paid during the payment period for the tax year are not taken into account in determining taxable income.

Section 1388(a) of the Code defines a patronage dividend as an amount paid to a patron (1) on the basis of the quantity or value of business done with or for the patron, (2) under an obligation of the organization to pay the amount, which obligation existed before the organization received the amount paid, and (3) that is determined by reference to the net earnings of the organization from business done with or for its patrons. A patronage dividend does not include any amount paid to the patron to the extent that (A) the amount is out of earnings other than from business done with or for patrons, or (B) the amount is out of earnings from business done with or for patrons to whom no amounts are paid, or to whom smaller amounts are paid, with respect to substantially identical transactions.

Section 1.1388-1(a)(1)(iii) of the Income Tax Regulations further defines a patronage dividend as an amount paid to a patron by a cooperative organization that is determined by reference to the net earnings of the cooperative from business done with or for its patrons. The term "net earnings" includes the excess of amounts retained (or assessed) by the organization to cover expenses or other items over the amount of such expenses or other items. In addition, "net earnings" are not reduced by any taxes imposed by subtitle A of the Code, but are reduced by dividends paid on capital stock or other proprietary capital interests.

Rev. Rul. 74-161, 1974-1 C.B. 247, holds that a state income tax imposed on and paid by a nonexempt farmers' cooperative on earnings from business done with nonmembers only does not reduce the earnings from business done with members in computing the amount available for distribution as a patronage dividend.

Unlike the situation in Rev. Rul. 74-161, in the present situation, the business and corporation privilege tax of State *X* is imposed on the taxpayer's adjusted net taxable income from all sources, including both patronage and nonpatronage sourced income. Under section 1.1388-1(a)(1)(iii) of the regulations, patronage dividends are based on net earnings of the cooperative, which are computed only after taking expenses into account. Because the tax imposed by State *X* is imposed on the cooperative's net income, which includes both patronage and nonpatronage sourced income, the expense incurred by the taxpayer in paying the tax must be taken into account for purposes of determining the amount of patronage dividends.

HOLDING

A nonexempt farmers' cooperative must allocate to both its patronage and nonpatronage sourced income the tax imposed by State *X* before computing the amount available for distribution as patronage dividends under section 1388 of the Code.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 74-161 is distinguished.

Chapter 2.—Tax on Self-Employment Income

Section 1402.—Definitions

26 CFR 1.1402(a)-8: Community income.

Community property states. The Service will follow the decisions in *Carrasco v. Secretary of Health, Education and Welfare, Becker v. Harris,* and *Hester v. Harris,* for purposes of the Self-Employment Contributions Act (SECA). The rule in community property states will be the same as in non-community property states and, pursuant to section 1402(a) of the Code, in the absence of a partnership, only the spouse carrying on the trade or business will be subject to the taxes imposed under the SECA.

Rev. Rul. 82-39

FACTS

The court in the case of *Carrasco v. Secretary of Health, Education and Welfare*, 628 F. 2d 624 (1st Cir. 1980), held that a provision of the Social Security Act, 42 U.S.C. 411(a)(5)(A) (1976), discriminates on the basis of sex in violation of the fifth amendment of the Constitution. Similar conclusions were reached in *Becker v. Harris*, 493 F. Supp. 991 (E.D. Cal. 1980), and *Hester v. Harris*, 631 F.2d 53 (5th Cir. 1980). Section 411(a)(5)(A) of 42 U.S.C. provides that if any of the income derived from a trade or business (other than a trade or business carried on by a partnership) is community income under the community property laws applicable to such income, all of the gross income and deductions attributable to such trade or business shall be treated as the gross income and deductions of the husband, unless the wife exercises substantially all of the management and control of such business, in which case all of such gross income and deductions shall be treated as the gross income and deductions of the wife. Section 1402(a)(5) of the Internal Revenue Code, relating to the Self-Employment Contributions Act (SECA), uses identical language.

HOLDING

The Internal Revenue Service will follow the decisions in *Carrasco v. Secretary*, *Becker v. Harris* and *Hester v. Harris*, for purposes of the SECA. Therefore, the rule in community property states will be the same as in non-community property states and pursuant to section 1402(a) of the Code, in the absence of a partnership, only the spouse carrying on the trade or business will be subject to the taxes imposed under the SECA. The identity of the person carrying on the trade or business is a factual issue to be determined in each situation.

Chapter 3.—Withholding of Tax on Nonresident Aliens and Foreign Corporations and Tax-free Covenant Bonds

Subchapter A.—Nonresident Aliens and Foreign Corporations

Section 1441.—Withholding of Tax on Nonresident Aliens

26 CFR 1.1441-1: Requirement for withholding of tax on non-resident aliens, foreign partnerships, and foreign corporations.

Requirements and conditions under which Forms 1042S withholding information returns may be filed on magnetic tape. See Rev. Proc. 82-13, page 447.

Section 1442.—Withholding of Tax on Foreign Corporations

26 CFR 1.1442-1: Withholding of tax on foreign corporations.

Requirements and conditions under which Forms 1042S withholding information returns may be filed on magnetic tape. See Rev. Proc. 82-13, page 447.

Section 1443.—Foreign Tax-Exempt Organizations

26 CFR 1.1443-1: Foreign tax-exempt organizations.

Requirements and conditions under which Forms 1042S withholding information returns may be filed on magnetic tape. See Rev. Proc. 82-13, page 447.

Subchapter C.—Application of Withholding Provisions

Section 1461.—Liability for Withheld Tax

26 CFR 1.1461-2: Return of tax withheld.

Requirements and conditions under which Forms 1042S withholding information returns may be filed on magnetic tape. See Rev. Proc. 82-13, page 447.

Section 1462.—Withheld Tax as Credit to Recipient of Income

26 CFR 1.1462-1: Withheld tax as credit to recipient of income.

Requirements and conditions under which Forms 1042S withholding information returns may be filed on magnetic tape. See Rev. Proc. 82-13, page 447.

Section 1463.—Tax Paid by Recipient of Income

26 CFR 1.1463-1: Tax paid by recipient of income.

Requirements and conditions under which Forms 1042S withholding information returns may be filed on magnetic tape. See Rev. Proc. 82-13, page 447.

Section 1464.—Refunds and Credits with Respect to Withheld Tax

26 CFR 1.1464-1: Refunds or credits.

Requirements and conditions under which Forms 1042S withholding information returns may be filed on magnetic tape. See Rev. Proc. 82-13, page 447.

Chapter 5.—Tax on Transfers to Avoid Income Tax

Section 1491.—Imposition of Tax

26 CFR 1.1491-1: Imposition of tax.

Whether a contribution to capital made by a domestic corporation to its wholly-owned foreign subsidiary is subject to the excise tax imposed by section 1491. See Rev. Rul. 82-112, page 59.

Chapter 6.—Consolidated Returns

Subchapter A.—Returns and Payment of Tax

Section 1502.—Regulations

26 CFR 1.1502-3: Consolidated investment credit.

Whether the exception to the recapture rules of section 47 of the Code under section 1.1502-3(f)(2)(i) of the regulations on the transfer of section 38 property between members of a consolidated group is applicable when at the time of the transfer there was no intention to keep the section 38 property within the consolidated group? See Rev. Rul. 82-20, page 6.

26 CFR 1.1502-13: Intercompany transactions.

General guidelines used by the Commissioner in considering requests for consent to elect not to defer gain or loss on any deferred intercompany transactions under section 1.1502-13(c)(3) of the regulations are provided, as well as the proper time for filing an application for such consent. See Rev. Proc. 82-36, page 490.

26 CFR 1.1502-42: Mutual savings banks, etc.

T.D. 7815

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Bad debt deduction for thrift institutions that join in filing consolidated returns

AGENCY: Internal Revenue Service, Treasury.

ACTION: Amendment of final regulations.

SUMMARY: This document amends existing final regulations relating to the percentage bad debt deduction for thrift institutions that join in filing consolidated returns by changing the effective date of the regulations. The existing regulations would have been effective for taxable years beginning after December 31, 1980.

DATES: This document makes the existing regulations effective only for taxable years for which the due date (without extensions) for filing returns is after March 14, 1983.

FOR FURTHER INFORMATION CONTACT: Benedetta A. Kissel of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue N.W., Washington, D.C. 20224 (Attention: CC:LR:T, 202-566-3238, not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

Section 1.1502-42 relates to the percentage bad debt deduction for thrift institutions that join in filing consolidated returns. Final regulations amending §1.1502-42 were published in the Federal Register for August 9, 1979 (44 FR 46838) as T.D. 7637 [1979-2 C.B. 311]. Proposed amendments to those final regulations were published in the Federal Register for January 30, 1981 (46 FR 9965) [LR-108-80, 1981-1 C.B. 753]. The final regulations would have applied for taxable years begining after December 31, 1980. The effect of this Treasury decision is generally to postpone the effective date one year. If the amendments proposed on January 30, 1981, are finalized, the effective date of the amendments will conform to this change in the effective date of the final regulations.

DRAFTING INFORMATION

The principal author of this regulation is Benedetta A. Kissel of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, on matters of both substance and style.

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 1 is amended as follows:

Section 1.1502-42 is amended by revising paragraph (c), the heading of paragraph (d), and the first sentence of paragraph (d), and the first sentence of paragraph (d)(1). The revised provisions read as follows:

§1.1502-42. Mutual savings banks, etc.

* * * * *

(c) *Taxable income; taxable years for which the due date (without extensions) for filing returns is before March 15, 1983.* For taxable years for which the due date (without extensions) for filing returns is before March 15, 1983, a member's taxable income for purposes of section 593(b)(2) is determined under §1.1502-27(b) (computed without regard to any deduction under section 593(b)(2)). In addition, for taxable years beginning after July 11, 1969, taxable income as computed under the preceding sentence is subject to the adjustments provided in section 593(b)(2)(E). See §1.593-6A(b)(5).

(d) *Taxable income; taxable years for which the due date (without extensions) for filing returns is after March 14, 1983*—(1) *In general.* For a taxable year for which the due date (without extensions) for filing returns is after March 14, 1983, a member's taxable income for purposes of section 593(b)(2) is the portion of consolidated taxable income attributable to the member.***

* * * * *

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impractical to issue it with notice and public procedure under subsection (b) of the section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in section 1502 and 7805 of the Internal Revenue Code of 1954 (68A Stat. 367 and 917; 26 U.S.C. 1502 and 7805).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved March 11, 1982.

JOHN E. CHAPOTON,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on March 12, 1982, 4:12 p.m., and published in the issue of the Federal Register for March 17, 1982, 47 F.R. 11515)

Subchapter B.—Related Rules
Part II.—Certain Controlled Corporations

Section 1563.—Definitions and Special Rules

26 CFR 1.1563-1: Definition of controlled group of corporations and component members.

Ct. D. 2010

SUPREME COURT OF THE UNITED STATES
No. 80-1251

United States, Petitioner v.
Vogel Fertilizer Company

[455 U.S. 16]

On Writ of Certirorari to the
United States Court of Claims

[January 13, 1982]

Syllabus

No. 80-1251. Argued November 3, 1981—Decided January 13, 1982

Section 1561(a) of the Internal Revenue Code of 1954 limits a "controlled group of corporations" to a single surtax exemption. Section 1563(a)(2) provides that a "controlled group of corporations" includes a "brother-sister controlled group," defined as "[t]wo or more corporations if 5 or fewer persons . . .own. . .stock possessing (A) at least 80 percent of the total combined voting power. . .or at least 80 percent of the total value. . .of each corporation, and (B) more than 50 percent of the total combined voting power. . .or more than 50 percent of the total value. . .of each corporation. . ., taking into account the stock ownership of each such person only to the extent such stock ownership is identical with respect to each such corporation." An implementing Treasury Regulation interprets the statutory term "brother-sister controlled group" to mean two or more corporations if the same five or fewer persons own "*singly or in combination*" the two prescribed percentages of voting power or total value. One shareholder, Vogel, owned 77.49% of the outstanding stock of respondent Vogel Fertilizer Co. Another shareholder, Crain, owned the remaining 22.51%. Vogel also owned 87.5% of the voting power in Vogel Popcorn Co. and 90.66-93.42% of the value of its stock. Crain owned no stock in Vogel Popcorn. Respondent claimed refunds for taxes paid in certain tax years for which it did not claim a full surtax exemption, asserting that respondent and Vogel Popcorn were not members of a controlled group and respondent was therefore entitled to a full surtax exemption for each taxable year. When the Internal Revenue Service disallowed the refund claims, respondent filed suit for refund in the Court of Claims, which held that respondent was entitled to a refund.

Held: The implementing Treasury Regulation is invalid as not being a reasonable interpretation of the statute, which, as indicated by its language, structure, and legislative history, was intended to apply only where each person whose stock is taken into account for purposes of the 80-percent requirement owns stock in each corporation of the group.

(a) Since the Regulation was promulgated only under the Commissioner of Internal Revenue's general authority to prescribe all needful rules and regulations, it is owed less deference than a regulation issued under a specific grant of authority to define a statutory term. Moreover, the Regulation purports to do no more than add a clarifying gloss on a term already specifically defined by Congress.

(b) The statutory language is in closer harmony with respondent's interpretation than with the Regulation in question. The term the statute defines—"brother-sister controlled group"—connotes a close horizontal relationship *between* two or more corporations, suggesting that the same indivisible group of five or fewer persons must represent 80 percent of the ownership of each corporation. This interpretation is strengthened by the structure of the statute, which suggests that precisely the same shareholders must satisfy both the 80-percent and 50-percent requirements. Since under Part (B)'s 50-percent requirement, stock ownership is taken into account only to the extent it is "identical," that part of the statutory test clearly includes a common ownership requirement. And the mere fact that there are no words in Part (A) explicitly requiring each shareholder to own stock in each corporation does not mean that the Regulation's interpretation, "singly or in combination," must be accepted as reasonable.

(c) The statute's legislative history makes it plain that the Regulation is not a reasonable statutory interpretation, where it appears that the intended targets of §1563(a)(2) were groups of *interrelated* corporations—corporations characterized by *common* control and ownership—and that Congress intended the *80-percent* requirement, as an expanded version of the former statute, to be the primary requirement for defining the interrelationship between two or more corporations, the 50-percent requirement being an additional proviso necessary in light of the expanded number of shareholders whose overlapping interests were to be considered. The "singly or in combination" provision of the Regulation is clearly incompatible with this intent.

225 Ct. Cl.____, 634 F. 2d 497, affirmed.

BRENNAN, J., delivered the opinion of the Court, in which BURGER, C. J., and MARSHALL, POWELL, REHNQUIST, STEVENS, and O'CONNOR, JJ., joined. BLACKMUN, J., filed a dissenting opinion, in which WHITE, J., joined.

JUSTICE BRENNAN delivered the opinion of the Court.

Section 1561(a) of the Internal Revenue Code of 1954, 26 U.S.C. §1561(a), limits a "controlled group of corporations" to a single corporate surtax exemption.[1] Section 1563(a)(2) provides that a "controlled group of corporations" includes a "brother-sister controlled group," defined as "[t]wo or more corporations if 5 or fewer persons. . .own. . .stock possessing (A) at least 80 percent of the total combined voting power. . .or at least 80 percent of the total value. . .of each corporation, and (B) more than 50 percent of the total combined voting power. . .or more than 50 percent of the total value. . .of each corporation. . ., taking into account the stock ownership of each such person only to the extent such stock ownership is identical with respect to each such corporation."[2] The interpretation of the statutory provision by Treas. Reg. §1.1563-1(A((3), 26 CFR §1.1563-1(a)(3) (1981), is that the "term 'brother-sister controlled group' means two or more corporations if the same five or fewer persons. . .own. . .*singly or in combination*" the two prescribed percentages of voting power or total value.[3] The question presented is whether the regulatory interpretation—that the statutory definition is met by the ownership of the prescribed stock by five or fewer persons "singly or in combination"—is a reasonable implementation of the statute or whethe Congress intended the statute to appl only where each person whose stock i taken into account owns stock in each corporation of the group.

I

Respondent, Vogel Fertilize Company (Vogel Fertilizer), an Iowa corporation, sells farm fertilizer products. During the tax years in question—1973, 1974 and 1975—Vogel Fertilizer had only common stock issued and outstanding and Arthur Vogel (Vogel) owned 77.49 percent of that stock. Richard Crain (Crain), who is unrelated to Arthur Vogel, owned the remaining 22.51 percent. Vogel Popcorn Company (Vogel Popcorn), another Iowa corporation, sells popcorn in both the wholesale and retail markets. For the tax years in question Crain owned no stock in Vogel Popcorn. Vogel, however, held 87.5 percent of the voting power, and be-

---

[1] For two of the tax years in question in this case—the years ending November 30, 1973 and 1974—the Code exempted the first $25,000 of corporate earnings from the federal surtax on corporate income, 26 U.S.C. §11(d) (1970 ed.), and for the third year—ending November 30, 1975—the Code exempted the first $50,000. 26 U.S.C. §11(d). For each of these tax years, however, §1561 of the Code limited the members of a "controlled group" of corporations to a single shared surtax exemption. Amendments to the Code in 1978 replaced the surtax exemption with a graduated five-step tax rate structure on taxable corporate income. 26 U.S.C. §11 (1976 ed., Supp. III). Now members of a controlled group must share a single rate schedule. 26 U.S.C. §1561(a) (1976 ed., Supp. III).

[2] The full text of §1563(a)(2) is:

"Brother-sister controlled group

"Two or more corporations if 5 or fewer persons who are individuals, estates, or trusts own (within the meaning of subsection (d)(2)) stock possessing—

"(A) at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of the stock of each corporation, and

"(B) more than 50 percent of the total combined voting power of all classes of stock entitled to vote or more than 50 percent of the total value of shares of all classes of stock of each corporation, taking into account the stock ownership of each such person only to the extent such stock ownership is identical with respect to each such corporation."

[3] The full text of the Treasury Regulation is:

"*Brother-sister controlled group.*

"(i) The term 'brother-sister controlled group' means two or more corporations if the same five or fewer persons who are individuals, estates, or trusts own (directly and with the application of the rules contained in paragraph (b) of §1.1563-3), singly or in combination, stock possessing—

"*(a)* At least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of the stock in each corporation; and

"*(b)* More than 50 percent of the total combined voting power of all classes of stock entitled to vote or more than 50 percent of the total value of shares of all classes of stock of each corporation, taking into account the stock ownership of each such person only to the extent such stock ownership is identical with respect to each such corporation.

"(ii) The principles of this subparagraph may be illustrated by the following examples:

"*Example (1).* The outstanding stock of corporations P, Q, R, S, and T, which have only one class of stock outstanding, is owned by the following unrelated individuals:

Individuals	Corporations					Identical ownership
	P	Q	R	S	T	
A	60%	60%	60%	60%	100%	60%
B	40%					
C		40%				
D			40%			
E				40%		
Total	100%	100%	100%	100%	100%	60%

Corporations P, Q, R, S and T are members of a brother-sister controlled group.

"*Example (2).* The outstanding stock of corporations U and V, which have only one class of stock outstanding, is owned by the following unrelated individuals:

Individuals	Corporations		Identical ownership
	U	V	
F	5%		
G	10%		
H	10%		
I	20%		
J	55%	55%	55%
K		10%	
L		10%	
M		10%	
N		10%	
O		5%	
Total	100%	100%	55%

Corporations U and V are not members of a brother-sister controlled group because at least 80 percent of the stock of each corporation is not owned by the same five or fewer persons."

tween 90.66 percent and 93.42 percent of the value of Vogel Popcorn's stock.[4]

Vogel Fertilizer did not claim a full surtax exemption on its tax returns for the years in question,[5] believing that Treas. Reg. §1.1563-1(a)(3) barred such a claim. But when the United States Tax Court, in 1976, held that Treas. Reg. 1.1563-1(a)(3) was invalid because the statute did not permit the Commissioner to take a person's stock ownership into account for purposes of the 80-percent requirement unless that person owned stock in each corporation within the brother-sister controlled group, *Fairfax Auto Parts of Northern Virginia, Inc.* v. *Commissioner*, 65 T.C. 798 (1976), rev'd, 548 F. 2d 501 (CA4 1977), Vogel Fertilizer filed timely claims for refunds, asserting that Vogel Fertilizer and Vogel Popcorn were not members of a controlled group and that Vogel Fertilizer was therefore entitled to a full surtax exemption for each taxable year. The Internal Revenue Service disallowed the claims and respondent brought this suit for a refund in the United States Court of Claims. The Court of Claims held that Vogel Fertilizer and Vogel Popcorn did not constitute a brother-sister controlled group within the meaning of §1563(a)(2)(A); that Treas. Reg. §1.1563-1(a)(3) is invalid to the extent that it takes into account, with respect to the 80-percent requirement, stock held by a shareholder who owns stock in only one corporation of the controlled group; and that respondent was, accordingly, entitled to a refund. 225 Ct. Cl.____, 634 F. 2d 497 (1980). We granted certiorari to resolve a conflict among the circuits on this issue, ____U.S.____ (1981),[6] and now affirm.

II

Arthur Vogel's ownership of more than 50 percent of both Vogel Fertilizer and Vogel Popcorn satisfies Part (B) of the statutory test—the 50-percent identical-ownership requirement. The controversy centers on Part (A) of the test—the 80-percent requirement.

Respondent argues that the statute must be construed as including a common-ownership requirement—Congress was attempting to identify interrelated corporations that are in reality subdivided portions of a larger entity. In the taxpayer's view, Congress thus did not intend that a person's stock ownership be taken into account for purposes of the 80-percent requirement unless that shareholder owned stock in *all* of the corporations within the controlled group. The same "5 or fewer" individuals cannot be said to control 80 percent of both Vogel Fertilizer and Vogel Popcorn because Crain owns no stock in Vogel Popcorn and therefore his 22.51 percent of Vogel Fertilizer cannot be added to Vogel's 77.49 percent of that corporation to satisfy §1563(a)(2)(A). The Commissioner takes the position, however, reflected in his addition of the words "singly or in combination" in Treas. Reg. §1.1563-1(a)(3) to the statutory language, that there is no common ownership requirement—various subgroups of "5 or fewer persons" can own the requisite 80 percent of the different corporations within the controlled group. The Commissioner acknowledges that under this interpretation, Part (A)'s 80-percent requirement in no respect measures the interrelationship between two corporations. The Commissioner's view is that only the 50-percent requirement measures this interrelationship. He contends the 80-percent requirement "continues to have independent significance" in that it "insures that all the members of the corporate group will be closely held," so that "the more-than-50-percent shareholder control group can obtain additional control in those instances where a greater interest is needed without the necessity of dealing with a large number of other shareholders." Brief for United States 35.[7]

A

Our role is limited to determining the validity of Treas. Reg. §1.1563-1(a)(3). Deference is ordinarily owing to the agency construction if we can conclude that the regulation "implement[s] the congressional mandate in some reasonable manner." *United States* v. *Correll*, 389 U.S. 299, 307 (1967) [Ct. D. 1917, 1968-1 C.B. 64].

---

[4] The remainder of the Vogel Popcorn stock—voting preferred stock—was owned by Arthur Vogel as trustee of the Alex Vogel Family Trust. Under the attribution rules of 26 U.S.C. §1563(d)(2), (e), Arthur Vogel is not deemed to own this stock for tax purposes. See *Vogel Fertilizer Co.* v. *United States*, 225 Ct. Cl. ____, 634 F.2d 497, 499 (1980).

[5] In the original version of §§1561-1563, controlled groups retained the option of taking multiple surtax exemptions and paying a penalty. See 26 U.S.C. §1562 (1964 ed.). During the tax years in question this option was being gradually phased out. 26 U.S.C. §1564. For 1973 and 1974 respondent utilized the multiple surtax exemption under 26 U.S.C. §1564(a), and paid the penalty imposed by §1562(b) (1970 ed.). FOR THE TAX YEAR ENDING November 30, 1975, respondent elected to allocate entirely to Vogel Popcorn the single surtax exemption then allowed to members of a controlled group of corporations.

[6] The Court of Appeals for the Fifth Circuit is in agreement with the Court of Claims and the Tax Court that Treas. Reg. §1.1563-1(a)(3), 26 CFR §1.1563-1(a)(3) (1981), is invalid insofar as it permits the 80-percent requirement to be satisfied without common ownership. *Delta Metalforming Co.* v. *Commissioner*, 632 F.2d 442 (1980). The Tax Court has adhered to its view that the Regulation is invalid. See *e.g.*, *Charles Baloian Co.* v. *Commissioner*, 68 T.C. 620, 629-631 (1977) [1978-2 C.B. 3]; *Davidson Chevrolet Co.* v. *Commissioner*, 39 TCM 299 (1979), ¶79,414 P-H Memo TC; *Allen Oil Co.* v. *Commissioner*, 38 TCM 355 (1979), ¶79,088 P-H Memo TC; *Delta Metalforming Co.* v. *Commissioner*, 37 TCM 1485 (1978), ¶78,354 P-H Memo TC; *T. L. Hunt, Inc.* v. *Commissioner*, 35 TCM 966 (1976), ¶76,221 P-H Memo TC. This adherence has persisted in the face of reversals by the Courts of Appeals for the Second, Fourth and Eighth Circuits. *Allen Oil Co.* v. *Commissioner*, 614 F.2d 336 (CA2 1980); *Fairfax Auto Parts of Northern Virginia* v. *Commissioner*, 548 F.2d 501 (CA4 1977) (*per curiam*); *T. L. Hunt, Inc.* v. *Commissioner*, 562 F.2d 532 (CA8 1977).

[7] The difference between the Commissioner's and the taxpayer's positions is illustrated by the following example:

Individuals	Corporations					Identical Ownership
	U	V	W	X	Y	
A	55%	51%	55%	55%	55%	51%
B	45%	49%				(45% in U & V)
C			45%			
D				45%		
E					45%	

The parties would agree that the 50-percent identical-ownership requirement in Part (B) is met for all corporations by shareholder A's identical ownership of 51 percent of all of the corporations. The Commissioner would find the 80-percent requirement met as well, and would therefore define all five corporations as part of a controlled group, because various subgroups of the five or fewer shareholder can account for 80 percent of each corporation. The taxpayer's position is that only corporations U and V are part of a brother-sister controlled group, because they are the only two corporations in which precisely the same five or fewer persons account for 80 percent of the stock of the putative "brother-sister controlled" corporations.

But this general principle of deference, while fundamental, only sets "the framework for judicial analysis; it does not displace it." *United States* v. *Cartwright*, 411 U.S. 546, 550 (1973).

The framework for analysis is refined by consideration of the source of the authority to promulgate the regulation at issue. The Commissioner has promulgated Treas. Reg. §1.1563-1(a)(3) interpreting this statute only under his general authority to "prescribe all needful rules and regulations." 26 U.S.C. §7805(a). Accordingly, "we owe the interpretation less deference than a regulation issued under a specific grant of authority to define a statutory term or prescribe a method of executing a statutory provision." *Rowan Cos.* v. *United States*, ____U.S.____, ____(1981). In addition, Treas. Reg. §1.1563-1(a)(3) purports to do no more than add a clarifying gloss on a term—"brother-sister controlled group"—that has already been defined with considerable specificity by Congress. The Commissioner's authority is consequently more circumscribed than would be the case if Congress had used a term " 'so general. . .as to render an interpretive regulation appropriate.' " *National Muffler Dealers Assn.* v. *United States*, 440 U.S. 472, 476 (1979) [Ct. D. 1997, 1979-1 C.B. 198], quoting *Helvering* v. *R. J. Reynolds Co.*, 306 U.S. 110, 114 (1939) [Ct. D. 1383, 1939-1 (Part 1) C.B. 225]. See also *Rowan Cos.* v. *United States, supra*.

B

We consider first whether the Regulation harmonizes with the statutory language. *National Muffler Dealers Assn.* v. *United States, supra*, at 477. That language, set forth at page 1 and note 2, *supra*, while not completely unambiguous, is in closer harmony with the taxpayer's interpretation than with the Commissioner's Regulation. The term that the statute defines—"brother-sister controlled group"—connotes a close horizontal relationship *between* two or more corporations, suggesting that the same indivisible group of five or fewer persons must represent 80 percent of the ownership of each corporaton.

This interpretation is strengthened by the structure of the statute. Section 1563(a)(2) defines the controlling group of shareholders ("5 or fewer"), and then sets forth the two ownership requirements (80-percent and 50-percent). This structure suggests that precisely the same shareholders must satisfy both the 80-percent and 50-percent requirements. As the Tax Court stated it, "5 or fewer persons" is the "conjunctive subject" of *both* requirements. *Fairfax Auto Parts of Northern Virginia* v. *Commissioner*, 65 T.C. 798, 803 (1976). Since under Part (B)'s 50-percent requirement, stock ownership is taken into account only to the extent it is "identical," that part of the statutory test clearly includes a common ownership requirement. If, as the statutory structure suggests, the shareholders whose holdings are considered for purposes of Part (A) must be precisely the same shareholders as those whose holdings are considered for purposes of Part (B), the former also requires common ownership.[8]

Of course, a Treasury regulation is not invalid simply because the statutory language will support a contrary interpretation. But the mere fact that there are no words in Part (A) explicitly requiring that each shareholder own stock in each corporation does not mean that the Regulation's interpretation, "singly or in combination," must be accepted as reasonable. This Court has firmly rejected the suggestion that a regulation is to be sustained simply because it is not "technically inconsistent" with the statutory language, when that regulation is fundamentally at odds with the manifest congressional design. *United States* v. *Cartwright*, 411 U.S. 546, 557 (1973). The challenged Regulation is not a reasonable statutory interpretation unless it harmonizes with the statute's "origin and purpose." *National Muffler Dealers Assn.* v. *United States, supra*, at 477.

C

The legislative history of §1563(a)(2) resolves any ambiguity in the statutory language and makes it plain that Treas. Reg. §1.1563-1(a)(3) is not a reasonable statutory interpretation. Through the controlled-group test, Congress intended to curb the abuse of multiple incorporation—large organizations subdividing into smaller corporations and receiving unintended tax benefits from the multiple use of surtax exemptions, accumulated earnings credits, and various other tax provisions designed to aid small businesses. S. Rep. No. 91-552, p. 134 (1969) [1969-3 C.B. 423]. The House Ways and Means Committee Report noted that "large organizations have been able to obtain substantial benefits. . .by dividing the organization's income among a number of related corporations. Your committee does not believe that large organizations which operate through multiple corporations should be allowed to receive the substantial and unintended tax benefits resulting from the multiple use of the surtax exemption and the other provisions of present law." H.R. Rep. No. 91-413, pt. 1, p. 98 (1969) [1969-3 C.B. 199]. The intended targets of §1563(a)(2) were groups of *interrelated* corporations—corporations characterized by *common* control and ownership. Although the 50-percent requirement measures, to a lesser degree, the overlap between two corporations, the history of the enactment of §1563(a)(2) illustrates that Congress intended that the *80-percent* requirement be the primary requirement for defining the interrelationship between two or more corporations.

---

[8] This interpretation of the statutory language is also strengthened by the presence of the phrase "each such person" in Part (B). The Tax Court pointed out:

"The words 'each such person' appearing therein refer to the 'five or fewer persons' constituting the ownership group for purposes of both the 80-percent and 50-percent tests. The import of such usage is that each person—and not just some of the persons—counted for purposes of the 80-percent test must be also counted for purposes of the 50-percent test." *Fairfax Auto Parts of Northern Virginia* v. *Commissioner*, 65 T.C. 798, 803 (1976).

The Government argues that there is no justification for singling out the phrase "each such person" in Part (B) of the test and transporting it for application in the context of Part (A). This argument, however, mischaracterizes the reasoning of the Tax Court. The court merely intended to show that the term "each such person" refers back to the antecedent "5 or fewer persons," which precedes the 80-percent requirement, thereby strengthening the suggestion that there is one fixed, indivisible, group of shareholders whose holdings are to be considered throughout application of both the 80-percent requirement in Part (A) and the 50-percent requirement in Part (B).

Until 1964, the method prescribed by the Code to curb the abuse of multiple incorporation was subjective: Multiple exemptions or benefits were allowed or disallowed depending on the reasons for the taxpayer's actions.[9] The Revenue Act of 1964 changed this approach, adding §§1561-1563 to the Code, Pub. L. 88-272, [1964-1 (Part 2) C.B. 6] §235(a), 78 Stat. 116-125. These sections prescribed the application of mechanical, objective tests for determining whether two corporations were a "controlled group" and thereby restricted to one surtax exemption. The original, 1964, definition of a "brother-sister controlled group" was:

> "Two or more corporations if stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of stock of each of the corporations is owned. . .by one person who is an individual, estate, or trust." 26 U.S.C. §1563(a)(2), 78 Stat. 120.

Because corporations were not part of a controlled group unless the same person owned 80 percent of all corporations within the group, the 1964 provision clearly included a common-ownership requirement.

In 1969 Congress adopted the present two-part percentage test codified in §1563(a)(2). Pub. L. 91-172, §401(c), 83 Stat. 599 [1969-3 C.B. 10]. This change was proposed by the Treasury Department as part of an extensive package of tax reform proposals. See Hearings Before the House Committee on Ways and Means on the Subject of Tax Reform, 91st Congress, 1st Sess., pt. 14, 5050-5478 (1969) (herinafter Hearings). The Treasury Department proposed, *inter alia*, that the definition of a brother-sister controlled group "be broadened to include groups of corporations owned and controlled by five or fewer persons, rather than only those owned and controlled by one person," as was the case under then existing law. Hearings, *supra*, at 5166. In setting forth the "Technical Explanation" for this new definition of brother-sister controlled groups, the Treasury Department was most explicit that the 80-percent requirement, like the 50-percent requirement, included common ownership: "The *same five* or fewer persons [must] own at least 80 percent of the voting stock or value of shares of *each* corporation and . . .*these* five or fewer individuals" must satisfy the 50-percent requirement in Part (B). Hearings, *supra*, at 5168 (emphasis added except for "*five*").

The Treasury Department's "General Explanation" of the amendment to §1563(a)(2) defined a brother-sister controlled group as one "in which five or fewer persons own, to a large extent in identical proportions, at least 80 percent of the stock of each of the corporations." Hearings, *supra*, at 5394 (footnote omitted). The General Explanation then set forth the respective roles of the expanded 80-percent requirement and the new 50-percent requirement:

> This provision expands present law by considering the combined stock ownership of five individuals, rather than one individual, in applying the 80-percent test. . . . However, in order that this expanded definition of brother-sister controlled group applies only to those cases where the five or fewer individuals hold their 80 percent in a way which allows them to operate the corporations as one economic entity, the proposal would add an additional rule that the ownership of the five or fewer individuals must constitute more than 50 percent of the stock of each corporation considering, in this test of ownership, stock of a particular person only to the extent that it is owned identically with respect to each corporation." *Ibid.*

The General Explanation made it clear that, under the 1969 amendment to §1563(a)(2), the 80-percent requirement would remain the primary basis for determining whether two or more corporations represent the *same* financial interests. Part (A) of the 1969 test was simply an expansion of the 1964 test, which considered the two or more corporations to be a brother-sister controlled group only when one person owned 80 percent of all of the corporations. This "expansion" was necessary to "close the present opportunity for easy avoidance" of the 80-percent test. Hearings, *supra*, at 5396. Because five persons now played the role previously played by one, this expanded version of the test required a new safeguard—the 50-percent requirement—to "insure that the new expanded definition is limited to cases where the brother-sister corporations are, in fact, *controlled* by the group of stockholders as one economic enterprise." *Id.* (emphasis added).[10]

The "singly or in combination" provision of Treas. Reg. §1.1563-1(a)(3) is clearly incompatible with the explanation offered by the Treasury Department when it proposed the statute. In addition to the explicit statement that the members of the controlling group must own stock in "each" corporation, the Treasury Department presented a test in which the 80-percent requirement remained the primary indicia of interrelationship. But under the challenged Regulation, the 80-percent requirement measures *only* whether or not the brother-sister corporations are closely held. The fact that a corporation is closely held, absent common ownership, is irrelevant to the congressional purpose of identifying interrelationship: "It is not the *smallness* of the number of persons in each company that triggers §1563; it is the *sameness* of that small number." *T. L. Hunt, Inc.* v. *Commissioner*, 562 F.2d 532,

---

[9] Before 1964, the Code provisions designed to prevent taxpayers from using the multiple form of corporate organization in order to avoid taxes were §§269, 482 and 1551. H. R. Rep. No. 749, 88th Cong., p. 117 (1963) [1964-1 (Part 2) C.B.125]. Section 269 gives the Secretary the authority to disallow a tax deduction, credit, or other allowance when an acquisition was made to avoid income tax. Section 482 gives the Secretary the authority to allocate income, deductions, credits, or allowances between or among taxpayers if he determines that such an allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of the taxpayers. Section 1551 permits the Secretary to disallow a surtax exemption or accumulated earnings credit when a transfer of property between two "controlled" corporations occurs, unless the taxpayer can show that the "major purpose" of the transfer was not the securing of such benefits. All of these sections are still in effect, but they are no longer the primary weapons employed against the abuse of multiple incorporation. Rather, the purely objective tests of §§1561-1563 have proved to be more effective. See Thomas, Brother-Sister Multiple Corporations—The Tax Reform Act of 1969 Reformed by Regulation, 28 Tax L. Rev. 65, 66-67 (1972).

[10] The Treasury Department's explanations included several examples applying the new definition of a brother-sister controlled group. In these examples, all shareholders whose stock was taken into account for purposes of the 80-percent requirement owned stock in each of the other corporations within the controlled group. See Hearings, *supra*, at 5169, 5170, 5395-5396.

537 (CA8 1977) (Webster, J. dissenting).[11]

The Treasury Department's explanations of the proposed statute are not, as the dissent in the Court of Claims suggested, a mere "admission against interest" by the Commissioner. 634 F.2d, at 514. The expanded definition of "brother-sister controlled group" was proposed by the Treasury Department and adopted in the same form in which it was presented. Of course, it is Congress' understanding of what it was enacting that ultimately controls. But we necessarily attach "great weight" to agency representations to Congress when the administrators "participated in drafting and directly made known their views to Congress in committee hearings." *Zuber* v. *Allen*, 396 U.S. 168, 192 (1969). The subsequent legislative history of §1563(a)(2) confirms that Congress adopted not only the proposal of the Treasury Department, but also the Department's explanation and interpretation which are wholly incompatible with the "singly or in combination" interpretation of the Regulation. The Ways and Means Committee Report stated:

> "This bill expands the definition [of a brother-sister controlled group] to include two or more corporations which are owned 80 percent or more (by voting power or value) by five or fewer persons (individuals, estates, or trusts) provided that these five or fewer persons own more than 50 percent of each corporation when the stock of each person is considered only to the extent it is owned identically with respect to each corporation."H. R. Rep. No. 91-413, [1969-3C.B. 199] pt. 1, p. 99 (1969).

The House Committee Report thus reflects the Treasury Department's explanations—the 80-percent requirement is an expanded version of the 1964 statute and measures overlapping interest, while the 50-percent requirement is an additional proviso necessary in light of the expanded number of shareholders whose overlapping interests were to be considered.[12]

D

The Commissioner's further reasons for sustaining his interpretation are unpersuasive.

The Commissioner relies on the fact that, in expanding the coverage of §1563(a)(2), Congress expressly adopted part of the language used in §1551(b)(2) of the Code to describe a transfer from one corporation to another "controlled" by the same "five or fewer" individuals. The Commissioner contends that Congress thereby approved the interpretation the Commissioner had placed on §1551(b)(2). Even if we could assume that Congress was aware of Treasury regulations interpreting §1551, promulgated only two years before §1563 was enacted, see 32 Fed. Reg. 3214-3216 (1967), the promulgated regulations do not support the Commissioner's present interpretation of the statutory language in §1563(a)(2). The regulations defining control under §1551 contain no language similar to the words "singly or in combination" found in Treas. Reg. §1.1563-1(a)(3) and they contain no suggestion that the Treasury Department had interpreted §1551(b)(2) as *not* having a common ownership requirement. See Treas. Reg. §1.1551-1(e), 26 CFR §1.1551-1(e).[13]

Also unpersuasive is the Commissioner's reliance on the fact that §1563(a)(2) is referred to in §1015 of the Employee Retirement Income Security Act of 1974 [Pub. L. 93-406, 1974-3 C.B.1], 26 U.S.C. §414.[14] From this the Commissioner infers congressional approval of all the regulations promulgated under §1563 (a)(2), including the Regulation at issue in this case. But it is the intent of the Congress that amended §1563(a), not the views of the subsequent Congress that enacted §414, that are controlling. See *Teamsters* v. *United States*, 431 U.S. 324, 354 n. 39 (1977). In any event, this passing reference in 26 U.S.C. §414(b), enacted only two years after Treas. Reg. §1.1563-1(a)(3) was promulgated, 37 Fed. Reg. 8068-8070 (1972), hardly constitutes legislative approval of a long standing administrative interpretation, from which we could infer any congressional acceptance. Cf. *United States* v. *Correll*, 389 U.S. 299, 305-306 (1967).

---

[11] The Commissioner strains to find some ambiguity in the Treasury Department's explanations. He points to the statement in the General Explanation that a brother-sister controlled group is a "group of corporations in which five or fewer persons own, *to a large extent in identical proportions*, at least 80 percent of the stock of each of the corporations." Hearings, *supra*, at 5394 (footnote omitted, emphasis added). The Commissioner contends that the underscored phrase suggests that there need not be common ownership among all those persons taken into account for purposes of the 80-percent requirement. But the words the Commissioner relies on only further support the taxpayer's position. If the shareholders own stock "to a large extent in identical proportions" they certainly own the stock to *some extent* in identical proportions—there is some overlap among *each* shareholder's holdings in *each* brother-sister corporation.

The dissent makes a similar effort, relying on the statement in the Technical Explanation that the 80-percent requirement "is satisfied if the *group* of five or more persons *as a whole* owns at least 80-percent of the voting stock or value of shares of each corporation, *regardless of the size of the individual holdings of each person*." *Post*, at 5 (emphasis in opinion). This language, however, also supports the taxpayer's interpretation since it appears to assume that "each person" *has* holdings in each corporation. This assumption is demonstrated by the three examples which directly follow this language and are used to illustrate it: The 80-percent requirement "is met whether one person owns 80 percent of the voting stock of each corporation, four persons each own 20 percent of the voting stock of each corporation, or one person owns 60 percent of the voting stock of one corporation and 40 percent of another, and another person owns 40 percent of the voting stock of the first and 60 percent of the second." Hearings, *supra*, at 5169.

[12] The Senate Committee Reports describe the amendment in language almost identical to that employed by the House Report. See S. Rep. No. 91-552, p. 135 (1969) [1969-3 C.B. 423]; Senate Committee on Finance, Summary of H. R. 13270, Tax Reform Act of 1969, 91st Cong., 1st Sess., 49 (Comm. Print 1969).

[13] The Commissioner relies on one of the examples used to define a "transfer" for purposes of §1551—a concept that obviously has no application under §1563(a)(2). See Treas. Reg. §1.1551-1(g)(4), 26 CFR §1.1551-1(g)(4). The example the Commissioner relies on provides: "Individual A owns 55 percent of the stock of corporation X. Another 25 percent of corporation X's stock is owned in the aggregate by individuals B, C, D, and E. On June 15, 1963, individual A transfers property to corporation Y (newly created for the purpose of acquiring such property) in exchange for 60 percent of the stock of Y, and B, C, and D acquire all the remaining stock of Y. The transfer is within the scope of section 1551(a)(3)." Treas. Reg. §1.1551-1(g)(4), Example (4), 26 CFR §1.1551-1(g)(4), Example (4).

Even if this example were read to suggest that a transferor "controls," within the meaning of §1551(b)(2), a transferee although the persons owning 80 percent of the transferor do not each own stock in the transferee, the example would be inapplicable to §1563(a)(2) because, as the Tax Court has pointed out, there is no method for determining which brother-sister corporation is to be regarded as the transferor and which as the transferee. See *Fairfax Auto Parts of Northern Virginia, Inc.*, *supra*, 65 T.C., at 807. See also Bonovitz, Brother-sister Controlled Groups under Section 1563: The 80 Percent Ownership Test, 28 Tax Lawyer 511, 524, 528-530 (1975).

[14] Section 414(b) provides in relevant part that "all employees of all corporations which are members of a controlled group of corporations (within the meaning of section 1563(a), determined without regard to section 1563(a)(4) and (e)(3)(C)) shall be treated as employed by a single employer."

Finally, the Commissioner seeks to uphold the Regulation on the ground that a common-ownership requirement leads to the assertedly nonsensical result that ownership of only one share could be determinative. For example, if Richard Crain owned but one share of Vogel Popcorn, then the 80-percent requirement would be met and the taxpayer corporation would be part of a controlled group even under the taxpayer's interpretation of the statute. This argument is without merit, for several reasons. First, Congress purposefully substituted the mechanical formula of §1563(a)(2) for the subjective, case-by-case, analysis that had previously prevailed. Inherent in such an objective test is a sharp dividing line that is crossed by incremental changes in ownership. Moreover, it is obvious that a shareholder would not buy a small amount of stock in order to *create* a controlled group, since it is to the taxpayer's advantage not to be part of such a group. Finally, a person's "mere" ownership of one share of stock plays an important role in the operation of the test. It insures that each of the "5 or fewer" shareholders representing the bulk of the financial interest of the corporations actually knows of the other corporations within the putative brother-sister controlled group. Under this construction of the statute, controlled-group membership cannot catch such a shareholder by surprise, as it could under the Commissioner's construction.

Subtitle B.—Estate and Gift Taxes
Chapter 11.—Estate Tax
Subchapter A.—Estate of Citizens or Residents
Part II.—Credits Against Tax

Section 2011.—Credit For State Death Taxes

26 CFR 20.2011-1: Credit for State death taxes.

For purposes of determining the amount of the lien imposed by section 6324B of the Code, what is the amount of the section 2011 credit to be used under section 2032A(c)(2)(C) in computing what would have been the estate tax liability but for the section 2032A election? See Rev. Rul. 82-35, page 128.

Section 2014.—Credit For Foreign Death Taxes

26 CFR 20.2014-1: Credit for foreign death taxes.
(Also Section 2053; 20.2053-6.)

Foreign death tax credit; Canada. The Canadian tax on capital gains on the deemed disposition of real property at decedent's death is not an inheritance, legacy, or estate tax for purposes of section 2014 of the Code and, therefore, a foreign death tax credit is not allowed for payment of the tax. However, a deduction in the amount of the tax is allowable under section 2053(a)(3) as a claim against the decedent's estate.

Rev. Rul. 82-82

ISSUE

For purposes of section 2014 of the Internal Revenue Code, is a credit for foreign death taxes allowable for the Canadian tax on appreciated property imposed at the death of a decedent who was a United States citizen?

FACTS

D, the decedent, was a United States citizen domiciled in the United States at the time of death in 1981. *D* owned appreciated real property located in Canada at the time of death. The Canadian National Department of Revenue determined that, under the Canadian Income Tax Act of 1971, a gain resulted from a deemed disposition of the real property at *D*'s death. A tax on that gain was paid from the decedent's estate.

The Canadian Income Tax Act of 1971 repealed that country's estate tax laws with respect to decedents dying after December 31, 1971. The Act substituted a tax on appreciation in place of the former estate tax. See section 70(5) of the Income Tax Act, Ch. 63, S.C. 1970-71-72. With certain exceptions, a decedent is by reason of death deemed to have received proceeds equal to the fair market value of each capital asset the same as though he or she disposed of that property immediately before death. Subject to limitations imposed by certain transition rules, the difference between the value of the proceeds received from these deemed dispositions and the decedent's adjusted basis in the property produces a gain or loss on each deemed disposition. Thus, the decedent's estate is subject to income tax on the net gain resulting from these deemed dispositions.

In computing the United States federal estate tax, the executor of *D*'s estate claimed a credit for foreign death taxes for the tax paid to Canada.

LAW AND ANALYSIS

Section 2001 of the Code imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2014 of the Code provides a credit against the federal estate tax imposed on the estate of a citizen or resident for any estate, inheritance, legacy, or succession taxes paid to a foreign country on property situated in that country when that property is also included in the decedent's gross estate for federal estate tax purposes.

The characterization of a foreign tax as an estate, inheritance, legacy, or succession tax is controlled by United States law. Unless the foreign tax is substantially equivalent to an estate, inheritance, legacy, or succession tax as that term is understood in the United States, it will not qualify for the credit provided by section 2014 of the Code. See generally, *Biddle v. Commissioner*, 302 U.S. 573 (1938), 1938-1 C.B. 309; and *Bank of America v. United States*, 459 F.2d 513 (Ct. Cl. 1972).

The common element in estate, inheritance, legacy, and succession taxes is that they are all taxes imposed on the value of the property transferred from a decedent to an heir. See *Knowlton v. Moore*, 178 U.S. 41, 56 (1900). The Canadian tax under consideration is not a transfer tax. Rather, it recognizes gain or loss with respect to a decedent's property. If the property has neither appreciated nor depreciated during the decedent's ownership, no tax would be assessed for the deemed disposition. Accordingly, the tax is not substantially equivalent to an estate, inheritance, legacy, or succession tax for purposes of section 2014 of the Code.

Pursuant to Articles I and V of the United States-Canada Estate Tax Convention, which was effective April 9, 1962, when both the United States and Canada impose an estate tax or any other tax of a substantially similar character on Canadian-based property of a United States citizen or domiciliary, there shall be allowed as a credit against the tax imposed by section 2001 of the Code an amount equal to the tax imposed by Canada on such property. However, because the Canadian tax at death under the Income Tax Act is not an estate tax or a tax of a substantially similar character, the federal estate tax credit provided under Article V of the United States-Canada Estate Tax Convention is not applicable to the Canadian tax imposed on deemed dispositions on account of death.

HOLDING

Neither the foreign death tax credit provided by section 2014 of the Code nor the estate tax credit provided under Article V of the United States-Canada Estate Tax Convention is allowable for the payment of the Canadian tax imposed under section 70(5) of the Income Tax Act. However, a deduction in the amount of the tax is allowable under section 2053(a)(3) of the Code as a claim against the decedent's estate. See section 20.2053-6(f) of the Estate Tax Regulations.

Part III.—Gross Estate

Section 2031.—Definition Of Gross Estate

26 CFR 20.2031-2: Valuation of stocks and bonds.

What are the estate tax consequences when proceeds of a life insurance policy on a decedent's life are payable to a wholly owned corporation of the decedent and then to the decedent's estate pursuant to a stock redemption agreement? See Rev. Rul. 82-85, page 137.

Section 2032.—Alternate Valuation

26 CFR 20.2032-1: Alternate valuation.

Whether property passing to a surviving spouse under an "estate equalization clause" qualifies for an estate tax marital deduction under section 2056 of the Code. See Rev. Rul. 82-23, page 139.

Section 2032A.—Valuation of Certain Farm Etc., Real Property

(Also Sections 2011, 6324B; 20.2011-1.)

Farms; special use value; liens. The section 2011 credit, used under section 2032A(c)(2)(C) of the Code in computing what would have been the estate tax liability but for the section 2032A election, is derived with respect to three different types of state death tax statutes. The computation is made for the purpose of determining the amount of the lien imposed by section 6324B.

Rev. Rul. 82-35

ISSUE

For purposes of determining the amount of the lien imposed by section 6324B of the Internal Revenue Code, what is the amount of the section 2011 credit to be used under section 2032A(c)(2)(C) in computing what would have been the estate tax liability but for the section 2032A election?

FACTS

Situation 1

D, a resident of state *X*, died in 1981. The executor of *D*'s estate elected, under section 2032A of the Code, to value farmland included in *D*'s gross estate based on the value of the property as farmland, rather than at the fair market value of the property. Thus, the farmland was included at a lesser value than it would have been if no election had been made, and the taxable estate was reduced accordingly.

The maximum allowable credit for state death taxes paid, computed in accordance with section 2011(b) of the Code, was 10*x* dollars. If the election to value the farmland under section 2032A had not been made, the maximum allowable credit under section 2011(b) would have been 15*x* dollars.

State *X* imposes a state death tax in an amount equal to the maximum allowable state death tax credit under section 2011 of the Code. Therefore, the amount of the state death tax paid was 10*x* dollars. If the election to value the farmland under section 2032A had not been made, the amount of the state death tax paid would have been 15*x* dollars. The statute of limitations on the state death tax is 3 years.

Situation 2

The facts are the same as in *Situation 1* except that *D* was a resident of State *Y*, which imposes a death tax equal to the greater of (i) an amount determined under a rate schedule set forth in the state's death tax statute or (ii) an amount equal to the maximum allowable state death tax credit under section 2011 of the Code. The state death tax imposed and paid as a result of *D*'s death was 11*x* dollars, an amount in excess of the allowable section 2011 credit. The statute of limitations on the state death tax is 3 years.

Situation 3

The facts are the same as in *Situation 1* except that *D* was a resident of State *Z*. Under a provision in the state death tax statute of State *Z* that is similar to section 2032A of the Code, the executor elected to value the farmland for state death tax purposes based on its use as a farm. The estate's actual state death tax liability was 11*x* dollars. If the executor had not elected to value the farmland for state death tax purposes based on its use as a farm, the estate's state death tax liability would have been 17*x* dollars. State *Z* provides for an additional state death tax in circumstances identical to those that would result in the imposition of an additional federal tax under section 2032A(c). Under the state statute, this additional tax is computed on the basis of provisions similar to section 2032A(c)(2)(A)(i) and (ii) and would total 6*x* dollars.

LAW AND ANALYSIS

Section 2032A of the Code provides that, if certain requirements are satisfied, the executor may elect to value real property used for farming purposes based on the property's value as farmland rather than at its fair market value based on its highest and best use.

Under section 2032A(c)(1) of the Code, the federal estate tax benefit obtained as a result of this reduced valuation is subject to recapture if certain specified events occur. In the agreement required under section

2032A(a)(1)(B) and (d)(2), all parties who have an interest in the property being specially valued must consent to an additional estate tax in the event of a disqualifying disposition of the property or cessation of the qualified use.

Section 6324B of the Code imposes a lien on the property to ensure collection of this additional estate tax. The lien is equal to the "adjusted tax difference attributable to an interest" as defined in section 2032A(c)(2)(B).

Section 2032A(c)(2)(B) of the Code defines "adjusted tax difference attributable to an interest" as an amount that bears the same ratio to the "adjusted tax difference with respect to the estate" as the excess of the qualifying interest's fair market value over its value determined under section 2032A(a) bears to the excess of the fair market value of all qualifying interests over their value determined under section 2032A(a). Section 2032A(c)(2)(C) defines "adjusted tax difference with respect to the estate" as an amount equal to the excess of what would have been the estate tax liability but for the section 2032A election over the actual estate tax liability. "Estate tax liability" refers to the tax imposed by section 2001 less all allowable credits.

Section 2011 of the Code provides a credit against the tax imposed by section 2001 for any estate, inheritance, legacy, or succession taxes actually paid to any state. The credit is limited to the lower of the amount of tax actually paid to a state or the amount determined under section 2011(b). The allowance of a state death tax credit is dependent on the actual payment of the state death tax and on the claiming of the credit within 4 years after the filing of the estate tax return. See section 20.2011-1(c) of the Estate Tax Regulations.

In *Situation 1*, as noted, if there had been no election under section 2032A of the Code, the maximum allowable credit under section 2011(b) would have been 15*x* dollars. However, the section 2011 credit is limited to the amount of death tax actually paid to state *X*. See section 2011(a). Therefore, in computing under section 2032A(c)(2)(C) the estate tax liability in the absence of a section 2032A election, the section 2011 credit is 10*x* dollars, the amount of state death tax actually paid.

This result is the same regardless of whether state *X* would assess additional state death taxes if there was a section 2032A(c) disposition or cessation of the qualified use before the running of the 3-year state statute of limitations. Such an additional state tax has not yet been paid, and it is speculative whether it will be paid, even if generally enforced, because it can become payable only if there is a disposition or cessation prior to the running of the statute of limitations. Therefore, there is no basis for increasing the section 2011 credit for purposes of section 2032A(c)(2)(C) of the Code.

In *Situation 2*, as with *Situation* 1, the section 2011 credit to be used in computing under section 2032A(c)(2)(C) the estate tax liability in the absence of a section 2032A election, is the lesser of the maximum allowable credit under section 2011(b) if there had been no election under section 2032A (15*x* dollars) or the amount of the state death tax actually paid to state *Y* (11*x* dollars). Therefore, the amount of this credit is 11*x* dollars.

In *Situation 3*, the applicable state statute provides that an additional state death tax of 6*x* dollars will be imposed in every circumstance that will cause the imposition of the additional federal estate tax under section 2032A(c) of the Code. If there had been no election under section 2032A, the maximum allowable credit under section 2011(b) would have been 15*x* dollars. The total of the state death tax actually paid, 11*x* dollars, and the additional state death tax that would necessarily be imposed in the event of a disqualifying disposition or cessation of qualified use, 6*x* dollars, is 17*x* dollars. Therefore, in computing under section 2032A(c)(2)(C) the estate tax liability in the absence of a section 2032A election, the section 2011 credit is 15*x* dollars.

HOLDING

In states that do not provide for an additional death tax in circumstances identical to those that would result in the imposition of an additional federal tax under section 2032A(c) of the Code, the section 2011 credit, used in computing under section 2032A(c)(2)(C) the estate tax liability in the absence of a section 2032A election, will be the lesser of the maximum allowable credit under section 2011(b) if there had been no section 2032A election or the state death taxes actually paid.

In states that do impose such a recapture tax, the section 2011 credit, used in computing under section 2032A(c)(2)(C) of the Code the estate tax liability in the absence of a section 2032A election, will be the lesser of the maximum allowable credit under section 2011(b) if there had been no section 2032A election or the sum of the state death taxes actually paid and the potential state recapure tax.

---

26 CFR 20.2032A-4: Method of valuing farm real property.

Special use value; farms; interest rates. The interest rates to be used in computing the special use value of farm real property for which an election is made under section 2032A of the Code are listed for estates of decedents dying in 1982.

Rev. Rul. 82-104

This revenue ruling contains a list, applicable for estates of decedents dying in 1982, of the average annual effective rates on new Federal Land Bank loans to be used under section 2032A(e)(7)(A)(ii) of the Internal Revenue Code in computing the special use value of real property used as a farm for which an election is made under section 2032A. This revenue ruling also contains a list of the states within each land bank district.

Average annual effective interest rates, calculated in accordance with section 2032A(e)(7)(A) of the Code and 20.2032A-4(e) of the Estate Tax Regulations, to be used under section 2032A(e)(7)(A)(ii) are as follows:

Federal Land Bank District in which property is located	**Year of Death** 1982
Baltimore	10.48
Columbia	9.81
Houston	9.74
Louisville	10.02
New Orleans	9.88
Omaha	10.17
Sacramento	10.12
St. Louis	10.37
St. Paul	9.84
Spokane	10.13
Springfield	9.52
Wichita	10.26

Federal Land Bank Districts:

District	States
Baltimore	Delaware, District of Columbia, Maryland, Pennsylvania, Virginia, West Virginia.
Columbia	Florida, Georgia, North Carolina, South Carolina.
Houston	Texas.
Louisville	Indiana, Kentucky, Ohio, Tennessee.
New Orleans	Alabama, Louisiana, Mississippi.
Omaha	Iowa, Nebraska, South Dakota, Wyoming.
Sacramento	Arizona, California, Hawaii, Nevada, Utah.
St. Louis	Arkansas, Illinois, Missouri.
St. Paul	Michigan, Minnesota, North Dakota, Wisconsin.
Spokane	Alaska, Idaho, Montana, Oregon, Washington.
Springfield	Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island, Vermont.
Wichita	Colorado, Kansas, New Mexico, Oklahoma.

The rates applicable in the case of decedents dying in 1977, 1978, 1979, 1980, or 1981 are listed in Rev. Rul. 81-170, 1981-1 C.B. 454. Rev. Rul. 81-170 also contains an illustrative computation of an average annual effective interest rate.

---

26 CFR 20.2032A-8: Election and agreement to have certain property valued under section 2032A for estate tax purposes.

Valuation; special use value; retroactive election. Estates that were previously eligible for, but did not timely elect section 2032A valuation, cannot retroactively elect special use valuation under section 421(k)(5) of the Economic Recovery Tax Act of 1981.

Rev. Rul. 82-62

ISSUE

Under section 421(k)(5)(B) of the Economic Recovery Tax Act of 1981 (the Act), 1981-2 C.B. 256, 327, may an estate retroactively elect special use valuation under section 2032A of the Internal Revenue Code, if the federal estate tax return was due and filed after July 28, 1980, and before February 17, 1982, and at the time the return was filed the estate was eligible, regardless of the retroactive amendments, to make the election but did not do so?

FACTS

D died on March 30, 1980. At the time of *D*'s death, *D* owned real property used in the business of farming. *D*'s estate was eligible to value the farm property under the special use valuation provisions of section 2032A of the Code. However, *D*'s estate did not make the election, nor a protective election, on *D*'s estate tax return, filed on December 30, 1980. On September 30, 1981, *D*'s estate filed a claim for refund and notice of election for the special use valuation under section 2032A. *D*'s estate contended that is was eligible to elect special use valuation under the transitional rules of section 421(k)(5) of the Act.

LAW AND ANALYSIS

Section 2032A of the Code provides that, if certain conditions are satisfied, real property, includible in a decedent's gross estate, that is used for farming or other closely held business purposes may be valued on the basis of its current use rather than its fair market value. Section 20.2032A-8 of the Estate Tax Regulations provides that the election for special use valuation under section 2032A is made on the federal estate tax return filed for the estate.

Section 421 of the Economic Recovery Tax Act of 1981 amended section 2032A of the Code. Most of the amendments apply to the estates of decedents dying after December 31, 1981. However, the changes contained in sections 421(b)(1), (c)(2), (j)(1), and (j)(2) of the Act generally apply to the estates of decedents dying after December 31, 1976. See section 421(k)(5) of the Act.

As retroactively amended for estates of decedents dying after December 31, 1976, the pre-death qualified use requirement of section 2032A(b)(1) of the Code may be satisfied by either the decedent or a member of the decedent's family; the recapture tax under section 2032A(c) will not be imposed because of a qualified heir's failure to use the qualified real property if the qualified heir begins the use of the qualified real property before the date 2 years after the decedent's death; property transferred to a discretionary trust in which all the beneficiaries are qualified heirs may qualify for special use valuation; and property is considered as acquired from the decedent under section 2032(e) if it is purchased from the decedent's estate or trust.

Section 421(k)(5)(A) of the Act provides that the retroactive amendments noted above are generally applicable to estates of decedents dying after December 31, 1976. However, section 421(k)(5)(B) provides that the amendments are effective only for estates that made a timely election for special use valuation under section 2032A of the Code. If the time for filing the return and making the election would have otherwise expired after July 28, 1980, the time for making the election shall not expire before the date 6 months after the date of the enactment of the Act (February 16, 1982). See also section 421(k)(5)(C) providing rules regarding the reinstatement of elections previously revoked.

The transitional rules of section 421(k)(5) of the Act permit an estate to elect special use valuation (or to reinstate an election revoked prior to the Act's enactment) if the estate was previously ineligible to make the election, but can now qualify as a result of the retroactive changes specified above. See H.R. Rep. No. 97-201, 97th Cong., 1st Sess. 179 (1981), 1981-2 C.B. 352, 387, which provides:

> Estates for which estate tax returns were due and timely filed before enactment of the bill which are eligible to reinstate (or make) elections *because of these retroactive changes* will be allowed six months from the date of enactment of the bill in which to reinstate current use valuation elections. (Emphasis added.)

(Section 421(k)(5)(B), however, does not specify that it applied only to estates for which the estate tax returns were due and timely filed before August 13, 1981, the date of enactment of the Act. Therefore, this retroactive provision applies to estates for which returns were due and timely filed after July 28, 1980, and before February 17, 1982.)

Estates eligible to elect special use valuation regardless of these retroactive amendments are not affected by these retroactive amendments. Therefore, those estates are not covered by the transitional rules of section 421(k)(5). Consequently, the period during which such estates may make the election is not extended by the Act.

HOLDING

Under section 421(k)(5) of the Economic Recovery Tax Act of 1981, an estate may not retroactively elect special use valuation under section 2032A of the Code if the estate tax return was due and filed after July 28, 1980, and before February 17, 1982, and at the time the return was filed the estate was eligible, regardless of the retroactive amendments, to make the election but did not do so.

---

26 CFR 20.2032A-8: Election and agreement to have certain property valued under section 2032A for estate tax purposes.

Procedure for filing elections for special use valuation, reinstatements of elections, and claims for credit or refund when estates qualify for special use valuation under the retroactive provisions of the Economic Recovery Tax Act of 1981. See Rev. Proc. 82-9, page 413.

Section 2033.—Property In Which The Decedent Had An Interest

26 CFR 20.2033-1: Property in which the decedent had an interest
(Also Section 2042; 20.2042-1.)

Interests in property; survivors' loss benefits. Survivors' loss benefits paid under a no-fault automobile insurance policy are not property in which the decedent had an interest at death.

Rev. Rul. 82-5

ISSUE

Are survivors' loss benefits, payable under a no-fault automobile insurance policy, includible in the decedent's gross estate under the circumstances described below?

FACTS

The decedent, *D*, a resident of State *X*, died when the automobile that *D* owned and was driving was involved in a collision. Under State *X*'s no-fault automobile insurance statute, an owner of a motor vehicle registered in State *X* must carry no-fault insurance or maintain another form of financial security, such as a cash bond, for the payment of benefits specified in the statute. If the no-fault insurance is cancelled and no other satisfactory security is provided, the owner must relinquish the motor vehicle registration and cease to drive the car.

D complied with State *X*'s law by carrying a no-fault automobile insurance policy. Under the terms of *D*'s policy, the insurance company is to pay only those benefits specified in the statute, one of which is a survivors' loss benefit, payable when the insured dies as a result of an automobile accident. The survivors' loss benefit consists of certain amounts that the dependents of the insured decedent would have received from the insured for support during their dependency. If the decedent dies not survived by any dependent, no benefit is paid. The statute provides that the benefits otherwise required must be reduced by similar benefits provided or required to be provided to the decedent's dependents under the laws of any state or the Federal Government, such as workmen's compensation and social security benefits. The statute also provides that the insurance company shall be reimbursed for benefits that it paid to the extent that there is a subsequent recovery in a suit for wrongful death.

The decedent's spouse, *B*, the only dependent of the decedent, became entitled to receive a monthly annuity under the contract.

LAW AND ANALYSIS

Section 2033 of the Internal Revenue Code provides that the value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of death.

The decedent was required to obtain the coverage by the state's no-fault automobile insurance statute and had no choice as to the persons entitled to receive survivors' loss benefits or the amount of the benefits. The right to survivors' loss benefits was created by statute for the benefit of a decedent's dependents and is designed to compensate for amounts that they would have received from the decedent had the decedent lived. Since the loss for which the benefits are designed to compensate for did not accrue until after the decedent died, the right of the decedent's spouse to the benefits also did not arise until after the decedent died. Thus, the decedent had no interest in the survivors' loss benefits at the date of death and the benefits are not includible under section 2033 of the Code. See Rev. Rul. 56-637, 1956-2 C.B. 600, which holds that workmen's compensation benefits payable to the dependents of a deceased employee are not includible in the deceased's gross estate for federal estate tax purposes; Rev. Rul. 67-277, 1967-2 C.B. 322, which holds that the lump sum payable under section 402(i) of title 42 of the United States Code (the Social Security Act) to the widow or widower of the deceased is not includible in the decedent's gross estate for federal estate tax purposes; and Rev. Rul. 54-19, 1954-1 C.B. 179, which holds that amounts receivable in settlement of claims under the New Jersey "Death of Wrongful Act" statute are not includible in the decedent's gross estate.

Furthermore, the Service does not consider the survivor's loss benefits to be includible in the decedent's gross estate under section 2042 of the Code. While the Service takes no position on whether the survivor's loss benefits are classifiable as life insurance proceeds, nonetheless, the proceeds would not be includible in the decedent's gross estate because the decedent did not possess any incidents of ownership. Neither the power to cancel the policy and relinquish the motor vehicle registration nor the power to substitute a policy with identical survivor's benefits constitutes an incident of ownership within the meaning of section 2042. *See* Rev. Rul. 72-307, 1972-1 C.B. 307; *Jordahl v. Commissioner*, 65 T.C. 92 (1975), acq. 1977-1 C.B. 1.

HOLDING

The value of the survivor's loss benefits payable to *B* is not includible in the decedent's gross estate.

---

26 CFR 20.2033-1: Property in which the decedent had an interest.

The federal estate tax treatment of a contingent interest possessed by a decedent at the time of death is also includible under section 2037 of the Code. See Rev. Rul. 82-24, page 134.

---

26 CFR 20.2033-1: Property in which the decedent had an interest.

What are the estate tax consequences when proceeds of a life insurance policy on a decedent's life are payable to a wholly owned corporation of the decedent and then to the decedent's estate pursuant to a stock redemption agreement? See Rev. Rul. 82-85, page 137.

Section 2035.—Adjustments for Gifts Made Within 3 Years of Decedent's Death

Life insurance; transfer within 3 years of death; renewable group term life insurance policy. The value of a renewable group term life insurance policy is not includible in a decedent's gross estate under section 2035 of the Code when the decedent assigned the policy more than three years before death, but is considered to have made premium payments until death.

Rev. Rul. 82-13

ISSUE

Is the value of a renewable group term life insurance policy includible in the decedent's gross estate under section 2035 of the Internal Revenue Code when the decedent has assigned the policy more than three years before death, but is considered to make premium payments until death.

FACTS

D, the decedent, was an employee of *X* company, which covered its employees with a renewable group term life insurance policy. All premiums were paid by the *X* company. The policy was renewable upon payment of the annual premium at standard rates. No evidence of insurability was necessary for renewal.

On February 1, 1975, *D*, gratuitously assigned all rights under the policy (including any conversion privilege) to *A* and each subsequent yearly premium was paid by *D*'s employer, the *X* company. *D* died on May 1, 1980, possessing no incidents of ownership in the policy.

LAW AND ANALYSIS

Section 2035(a) of the Code generally provides that the gross estate shall include the value of all property interests transferred by a decedent within three years before death.

The initial purchase of a life insurance policy by a decedent who designates a third party as owner of the policy is a transfer of the policy for purposes of section 2035 of the Code and the entire proceeds will be includible in the decedent's gross estate if such purchase is within three years of death. *Detroit Bank & Trust Co. v. United States*, 467 F. 2d 964 (6th Cir. 1972), *cert. denied*, 410 U.S. 929 (1973); *First National Bank of Oregon v. United States*, 352 F. Supp. 1157 (D.C. Ore 1972), *aff'd*, 488 F. 2d 575 (9th Cir. 1973). The result is the same if the policy is initially purchased by the decedent as owner more than three years before death but is subsequently transferred by the decedent to a third party owner within three years of the decedent's death. The result is also the same where the decedent annually repurchases a policy that expires in its entirety each year and upon each repurchase designates a third party as owner. In such a case, each repurchase constitutes a new transfer for purposes of section 2035 of the Code, and the proceeds will be includible in the decedent's gross estate at death. See *Bel. v. United States*, 452 F. 2d 683 (5th Cir. 1971), *cert. denied*, 406 U.S. 919 (1972).

A term life insurance policy furnishes life insurance protection for a specified term, the face value of which is payable only if death occurs during the stipulated term. At the end of the policy term all premiums are fully earned, and all rights of the policy owner terminate. S. Huebner and K. Black, *Life Insurance* 73 (8th Ed. 1972). If, however, the policy contains a provision granting a right of renewal, the contract must be renewed upon demand (and payment of the premium) by the policy owner, without regard to the insurable status of the insured at the time. D. Gregg, and V. Lucas, *Life and Health Insurance Handbook*, 57 (3d ed. 1973).

In the instant case, the premiums paid by *X* company are attributable to *D*, for estate tax and gift tax purposes. See Rev. Rul. 76-490, 1976-2 C.B. 300. Thus, if the premium payment was deemed to purchase a new insurance contract each year, then the policy proceeds would be subject to inclusion under section 2035.

Under the group term policy considered here, there was an option for automatic renewal upon payment of the premium. This renewal was accomplished without providing evidence of insurability. The rights and obligations of the parties continued without interruption from the policy's inception, as long as the policy was renewed on each anniversary date. Thus, the payment of the premium at the time of the policy's renewal did not create new rights, nor was such payment a repurchase of insurance. The payment merely effectuated the continuation of an existing agreement. Therefore, when *D*, through *X* company, paid each renewal premium, it was not a new transfer of insurance coverage under section 2035 of the Code and the proceeds from the insurance policy are not includible in *D*'s gross estate.

Compare *Bel v. United States*, where payments of annual premiums after creation of the policy were each considered purchases of a new policy. In *Bel*, an accidental death policy was involved that did not provide a renewal privilege.

HOLDING

The value of the renewable group term life insurance policy is not includible in the decedent's gross estate under section 2035 of the Code when the decedent assigned the policy more than three years before death, but is considered to have made premium payments until death.

Section 2036.—Transfers With Retained Life Estate

26 CFR 20.2036-1: Transfers with retained life estate.

Charitable remainder trust; private annuity; valuation. The portion of a charitable remainder trust includible in the decedent-grantor's gross estate, where the decedent is the private annuitant, is that portion of trust corpus necessary to yield the private annuity payment, assuming a 6 percent return.

Rev. Rul. 82-105

ISSUE

For purposes of section 2036 of the Internal Revenue Code, what portion of the value of a charitable remainder annuity trust is includible in the grantor's gross estate when the grantor is the private annuitant for life?

FACTS

In 1974 *D* created a trust that qualified as a charitable remainder annuity trust under section 664 of the Code. The trust agreement provided for an annuity of 12*x* dollars to be paid each year to *D* for life and for the remainder upon *D*'s death to be distributed to *N*, a charitable organization described in section 2055(a). The trust was funded with 200*x* dollars. *D* died on March 1, 1980. The value of the trust assets on *D*'s date of death was 300*x* dollars. *D*'s executor did not elect to use the alternate valuation date.

LAW AND ANALYSIS

Section 2036(a)(1) of the Code provides, in part, that a decedent's gross estate shall include the value of any interest in property transferred by the decedent if the decedent retained for life the possession or enjoyment of, or the right to income from, the property.

Section 20.2036-1(a) of the Estate Tax Regulations provides generally that if the decedent retained or reserved an interest or right with respect to all of the property transferred by the decedent, the amount to be included in the gross estate under section 2036 of the Code is the value of the entire property on the date of death. If the decedent retained a right with respect to only part of the property transferred, the amount to be included in the decedent's gross estate under section 2036 is the proportionate amount of corpus.

Under the trust agreement *D* did not retain the right to the income from the cash transferred, but retained the right to receive the annuity amount. In effect, *D* has retained the right to income from a portion of the property transferred.

In order to determine the amount includible under section 2036 of the Code, it is necessary to ascertain the specific portion of corpus over which *D*, in effect, possessed an income interest.

In *Northeastern Pennsylvania National Bank & Trust Company v. United States*, 387 U.S. 213 (1967), Ct.D. 1916, 1967-2 C.B. 343, a bequest to the decedent's spouse of a fixed monthly stipend, payable from trust income or corpus, was held to satisfy the requirement of section 2056(b)(5) of the Code that the spouse receive all the income from a specific portion of trust corpus. The specific portion of corpus qualifying for the marital deduction was determined by computing the amount of corpus necessary to produce the guaranteed monthly payment, assuming a fixed rate of return.

This computation is discussed in *Citizens National Bank of Evansville v. United States*, 359 F.2d 817 (7th Cir. 1966), *cert. denied*, 387 U.S. 941 (1966), which involved an identical issue. The court computed the allowable marital deduction by capitalizing the annual annuity payment at an assumed rate of 3½% (rate specified under section 20.2031-7 of the reguations, applicable in the case of decedents dying prior to 1971).

In *Estate of Marvin L. Pardee v. Commissioner*, 49 T.C. 140 (1967), *acq.*, 1973-2 C.B. 3, the decedent created a trust and retained the right to use the income of the trust to satisfy a legal obligation of the decedent to pay, as child support, the sum of $500 per month. The court held that, under section 2036(a)(1) of the Code, the right retained by the decedent was the right to satisfy the legal obligation of $500 per month, and the amount includible in the decedent's estate was the amount which is required to yield monthly payments of $500 per month at 3½% (rate specified under section 20.2031-7 of the regulations, applicable in the case of decedents dying prior to 1971). *See also United States National Bank of Portland v. United States*, 188 F. Supp. 332 (D. Ore. 1960), which discusses a computation similar to the computation in *Pardee*.

For estate tax purposes, the annual rate of return of a charitable remainder annuity trust is presumed to be 6 percent in the case of decedents dying after December 31, 1970. See section 20.2031-10 of the Estate Tax Regulations. See also section 1.664-2(c) of the Income Tax Regulations which refers to section 20.2031-10 of the Estate Tax Regulations, and Rev. Rul. 77-374, 1977-2 C.B. 329. Therefore, in accordance with *Northeastern*, the portion of corpus over which *D* has retained a right to income is that portion which will yield an annuity of 12*x* dollars a year, assuming a 6 percent annual rate of return. At a 6 percent rate of return on investment, the amount of corpus necessary to generate 12*x* dollars per year is 200*x* dollars:

$$\frac{12x \text{ dollars}}{.06} = 200x \text{ dollars}$$

Accordingly, although the value of the corpus on *D*'s date of death was 300*x* dollars, only 200*x* dollars is includible in *D*'s gross estate under section 2036 of the Code. Alternatively, if the value of the trust assets was 200*x* dollars or less on *D*'s date of death, the entire corpus would be includible in *D*'s gross estate. Compare Rev. Rul. 76-273, 1976-2 C.B. 268, which demonstrates the application of section 2036 of the Code to a charitable remainder unitrust.

HOLDING

For purposes of section 2036 of the Code, the portion of the value of a charitable remainder annuity trust that is includible in *D*'s gross estate at death is the amount necessary, at the rate of 6 percent as specified under section 20.2031-10 of the regulations, to yield the guaranteed annual payment. In the instant case, the amount includible is 200*x* dollars $\left(\frac{12x \text{ dollars}}{.06} = 200x \text{ dollars}\right)$ However, because the 200*x* dollars constitutes part of the remainder interest passing to a charitable organization described in section 2055(a), the 200*x* dollars is deductible from *D*'s gross estate under section 2055. The amount of the charitable deduction cannot exceed the value of the transferred property required to be included in the gross estate. Section 2055(d).

The holding of this ruling applies ony to the portion of the value of a charitable remainder annuity trust that is includible in the gross estate under section 2036. The ruling does not consider the amount, if any, that may be includible in the gross estate under any other provisions of the Code.

Section 2037.—Transfers Taking Effect at Death

26 CFR 20.2037-1: Transfers taking effect at death.
(Also Section 2033; 20.2033-1.)

Trust; valuation; prior transfer of contingent remainder interest. A legally binding contract was entered into prior to the death of the life tenant between the two equal testamentary trust beneficiaries of contingent remainder interests providing that, if either predeceased the life tenant, then the survivor would transfer one-half of the trust corpus received to the heirs of the deceased. Upon the death of one of the beneficiaries prior to the death of the life tenant, the contract results in a transfer for purposes of section 2037 of the Code.

Rev. Rul. 82-24

ISSUE

Is section 2037 of the Code applicable in the situation described below?

FACTS

A died testate in 1974. Under the terms of *A*'s will, the residue of *A*'s estate was transferred to a testamentary trust divided into two equal parts, Part 1 and Part 2. The trust income from Parts 1 and 2 was to be paid to *B* for life. Upon the death of *B*, the trust was to terminate, at which time the corpus of Part 1 was to be paid to *C* and the corpus of Part 2 was to be paid to *D*.

The will further provided that, if either *C* or *D* predeceased *B*, the part otherwise payable to the deceased beneficiary was to pass to the survivor. If both *C* and *D* predeceased *B*, the corpus of Part 1 was to be paid to *C*'s estate and the corpus of Part 2 was to be paid to *D*'s estate. *B*, *C* and *D* survived *A*. *C* and *D* were the same age and sex.

In 1976, prior to *B*'s death, *C* and *D* had entered into an agreement providing that, if either *C* or *D* predeceased *B*, the part of the trust corpus that the deceased would have been entitled to, if both *C* and *D* had survived *B*, would be transferred to the heirs of the deceased.

C died in 1980 survived by two children, who were *C*'s sole heirs. At the time of *C*'s death, *B* and *D* were still living. Further, immediately before *C*'s death, the value of *C*'s right to receive Part 1 of the trust exceeded 5 percent of the value of Part 1. Under applicable local law, the contingent interests granted to *C* and *D* by *A* were freely alienable and the agreement was a binding contract at the time of its execution. *C*'s executor did not elect, under section 2032 of the Code, to value *C*'s estate on the alternate valuation date.

LAW AND ANALYSIS

Section 2037(a) of the Code provides that the gross estate includes the value of any property interest that a decedent transfers for less than an adequate and full consideration in money or money's worth, by trust or otherwise, if 1) possession or enjoyment of the property, through ownership of the transferred interest, can only be obtained by surviving the decedent, and 2) the decedent has retained a reversionary interest in the property, provided the value of the reversionary interest immediately before the decedent's death exceeds 5 percent of the value of the transferred property.

In the present case, prior to entering into the 1976 agreement, *C* owned three contingent interests in the trust corpus as follows:

(1) a right to receive part 1 of the trust corpus if *C* survived *B*;

(2) a right to receive Part 2 of the trust corpus if *C* survived *B* and *D* predeceased *B*; and

(3) a right (of *C*'s estate) to receive Part 1 of the trust corpus if both *C* and *D* predeceased *B*.

Under the 1976 agreement, *C* transferred to the heirs of *D* the right to receive Part 2 of the trust corpus if *C* survived *B*, and *D* predeceased *B*. Similarly, under the agreement, *D* transferred to the heirs of *C* the right to receive Part 1 of the trust corpus if *D* alone survived *B*. In all other respects, *C*'s rights in the trust corpus remained as they had been prior to the agreement. Consequently, immediately before *C*'s death in 1980, *C* owned two interests in Part 1, as follows:

(1) a right to receive Part 1 if *C* survived *B*; and

(2) a right (of *C*'s estate) to receive Part 1 if both *C* and *D* predeceased *B*.

Under the circumstances presented, *C*, by entering into the agreement, obtained a benefit for *C*'s heirs, and *D*, by entering into the agreement, obtained a benefit for *D*'s heirs. As a result of the transfers by *C* and *D*, which were of equal value, *C* and *D* have caused the benefits to be received by their respective children. Thus, *C* and *D* are considered to be the transferors of the interests received by their respective children. *C* is deemed to have transferred the contingent interest in Part 1 to *C*'s children. This transfer was without consideration in money or money's worth. See Rev. Rul. 79-238, 1979-2 C.B. 339, which discusses the gift tax consequences of a similar transaction. Ownership of this contingent interest entitled *C*'s children to possess Part 1 only if they survived *C*.

Further, *C* retained a possibility that Part 1 would vest in *C* (if *C* survived *B*) or *C*'s estate (if *C* and *D* predeceased *B*) under the terms of *A*'s will. *C*'s failure to transfer these interests in the trust corpus is the retention of reversionary interests for purposes of section 2037 of the Code. See *Spiegel's Estate v. Commissioner*, 335 U.S. 701, 705 (1949), 1949-1 C.B. 220.

Immediately before C's death, the value of these reversionary interests exceeded 5 percent of the value of Part 1. Consequently, the transaction is subject to section 2037 of the Code.

Under section 2037 of the Code, the amount includible in *C*'s gross estate is the entire value on the date of *C*'s death of Part 1 of the trust corpus less the value on the date of C's death of *B*'s life estate in Part 1. See *Fidelity-Philadelphia Trust Co. v. Rothensies*, 324 U.S. 108 (1945), 1945 C.B. 406; Rev. Rul. 76-178, 1976-1 C.B. 273.

HOLDING

The entire value of Part 1 of the trust corpus on the date of *C*'s death less the value of *B*'s life estate in Part 1 on the date of *C*'s death is includible in *C*'s gross estate under section 2037 of the Code, because of the indirect transfer of a contingent remainder interest in Part 1 to *C*'s children.

In addition, the value at the time of *C*'s death of the right of *C*'s estate to receive Part 1 of the trust corpus if both *C* and *D* predeceased *B* is includible under section 2033 of the Code as an interest owned by *C* at death. However, since this value is reflected in the inclusion under section 2037, no double inclusion is required.

In the situation described above, *C* and *D* are deemed to be the transferors of the interests received by their respective heirs to the extent *C* and *D* furnished the consideration for the transfers to their respective heirs. Consequently, if the interest actually transferred by *C* had a lower value than the interest actually transferred by *D* (if, for example, *C* were older than *D*), *C* would not be deemed the transferor of the interest received by *C*'s children to the extent of the difference in values of the interest actually transferred by *C* and *D*. See Rev. Rul. 79-238, cited above. The proportionate value of the interest received by *C*'s children attributable to the excess consideration furnished by *D* would be excluded from *C*'s gross estate under section 2037 of the Code.

Section 2041.—Powers Of Appointment

26 CFR 20.2041-1: Powers of appointment; in general.

Power of appointment; general; ascertainable standard. For purposes of section 2041 of the Code, the income beneficiary of a trust governed by Massachusetts law possesses a general power of appointment when the income beneficiary can invade the trust corpus for the beneficiary's "maintenance, comfort, and happiness." The Service will not follow the *Brantingham* decision.

Rev. Rul. 82-63

ISSUE

For purposes of section 2041 of the Internal Revenue Code, does the income beneficiary of a trust governed by Massachusetts law possess a general power of appointment if the beneficiary can invade the trust corpus for the beneficiary's "maintenance, comfort, and happiness"?

FACTS

In 1977, *A* established an irrevocable inter vivos trust. *D*, *A*'s spouse, was granted the lifetime right to income from the trust, as well as the right to invade corpus in such amounts as *D* deemed necessary for *D*'s maintenance, comfort, and happiness. Under the trust agreement, which was governed by Massachusetts law, the remainder interest passed to *C*. The *N* bank was appointed trustee. *D* died in 1981.

LAW AND ANALYSIS

Section 2041(a)(2) of the Code provides that the value of the gross estate shall be determined by including the value at the time of death of all property to the extent of any property with respect to which the decedent has at the time of death a general power of appointment created after October 21, 1942. Section 2041(b)(1) defines the term "general power of appointment" as a power which is exercisable in favor of the decedent, the decedent's estate, the decedent's creditors, or the creditors of the decedent's estate. However, section 2041(b)(1)(A) provides that a power to consume, invade, or appropriate property for the benefit of the decedent which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent shall not be deemed a general power of appointment.

Section 20.2041-1(c)(2) of the Estate Tax Regulations provides that a power to use the trust property for the comfort, welfare, or happiness of the decedent is not a power limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent. However, a power exercisable to support the holder in the holder's accustomed manner of living is a power limited by the requisite standard.

Although the federal statute controls in determining how the powers and rights possessed by the decedent are taxed, state law prevails in determining the nature and extent of the powers and rights possessed by the decedent. *Morgan v. Commissioner*, 309 U.S. 78 (1940), Ct. D. 1441, 1940-1 C.B. 229. Thus, whether the decedent's power to invade the trust corpus is limited by an ascertainable standard relating to health, education, support or maintenance is a matter of state law.

In *Dana v. Gring*, 374 Mass, 109, 371 N.E. 2d 755 (1977), the trust provided that the trustees could distribute trust corpus as they "deem necessary or desirable for the purpose of contributing to the reasonable welfare or happiness" of the settlor's daughter. The settlor's daughter was one of the trustees. The issue considered by the court was whether the daughter, by virtue of her position as trustee, possessed a power of appointment and, if so, whether the power was limited by an ascertainable standard.

The court found that under Massachusetts law the daughter, as trustee, could not not have participated in the trustee's decisions as to the amount that could have been distributed for her own benefit under the discretionary power, and, therefore, she did not possess a power of invasion. Even though the daughter had no power of invasion under Massachusetts law, the court, nevertheless, addressed the question of whether the trustees' power to distribute for the daughter's "welfare or happiness" was a power limited by an ascertainable standard. The court held that the trustees' power of distribution was fiduciary in nature and, therefore, was necessarily limited by a fiduciary obligation to safeguard the corpus for the remainderman. After viewing the trust instrument as a whole and considering the fiduciary restraints on the trustees' discretion, the court held that the trustees' discretionary power of distribution was limited to an amount necessary to support the daughter in accordance with her accustomed standard of living.

In *Brantingham v. United States*, 631 F.2d 542 (7th Cir. 1980), the decedent possessed a right to income from trust corpus, with the right to invade corpus in such amounts as she deemed necessary for her maintenance, comfort and happiness. The Seventh Circuit, relying on *Gring*, held that the decedent's power to invade the corpus was limited by an ascertainable standard under Massachusetts law, and the value of the property was not includible in her gross estate under section 2041 of the Code.

In *Brantingham*, the Seventh Circuit incorrectly extended the holding in *Gring* to a situation where a *nonfiduciary beneficiary* had a power to invade corpus for that beneficiary's "maintenance, comfort, and happiness." The discretionary power cons
ered by the court in *Gring* was a *fi*
ciary power of distribution and w
therefore, limited by the fiduciar
obligation to preserve the corpus
all beneficiaries. The court noted t
the trustees had to administer the tr
with "an eye to the remainder int
est." The power in *Brantingham* wa
power of invasion, exercisable by t
decedent in an individual capac
and, therefore, was not limited by a
fiduciary considerations regardi
preservation of the corpus for oth
beneficiaries.

In the present situation, as was t
case in *Brantingham*, *D* had the pow
to demand as much corpus as, in *D*
judgment, was necessary for *D*'s mai
tenance, comfort, and happiness. B
cause this power of invasion is diffe
ent from a trustee's power of distrib
tion, *Gring* does not apply. Unde
Massachusetts law, unambiguou
words in a trust instrument should b
given their ordinary meaning. *Se*
Hamlan v. Rednalloh Co., 291 Mass
119, 197 N.E. 149 (1935). The wor
"happiness", using its ordinary mean
ing, is so broad that, even when rea
in conjunction with the more specifi
terms "maintenance" and "comfort,
it confers on *D* a power to consume
trust corpus that goes beyond the limits of the statutory exception contained in section 2041(b)(1)(A) of the Code. Compare Rev. Rul. 77-194, 1977-1 C.B. 283; Rev. Rul. 77-60, 1977-1 C.B. 282. Accordingly, *D* possessed at death a general power of appointment requiring inclusion of the value of the trust property in *D*'s gross estate under section 2041 of the Code. The Service will not follow the Seventh Circuit's holding in *Brantingham* that, under Massachusetts law, the limitation "maintenance, comfort, and happiness" is an ascertainable standard relating to the health, education, support, or maintenance of the decedent.

HOLDING

For purposes of section 2041 of the Code, the income beneficiary of a trust governed by Massachusetts law possesses a general power of appointment when the income beneficiary can invade trust corpus for the beneficiary's "maintenance comfort, and happiness."

Section 2042.—Proceeds Of Life Insurance

26 CFR 20.2042-1: Proceeds of life insurance. (Also Sections 2031, 2033; 20.2031-2, 20.2033-1.)

Life insurance; corporation as beneficiary; stock redemption. Proceeds of a life insurance policy on a decedent's life, payable to a wholly owned corporation of the decedent and then to the decedent's estate pursuant to a stock redemption agreement, should be reflected in the valuation of the decedent's stock, which is included in the decedent's gross estate under section 2033 of the Code. The insurance proceeds are not separately included in the decedent's gross estate under section 2042.

Rev. Rul. 82-85

ISSUE

What are the estate tax consequences when proceeds of a life insurance policy on a decedent's life are payable to a wholly owned corporation of the decedent and then to the decedent's estate pursuant to a stock redemption agreement?

FACTS

D was the sole shareholder of *X* Corporation. At the request of *D*, the Board of Directors caused *X* Corporation to obtain and pay the premiums on a life insurance policy on *D*'s life. The face value of the policy was 50*x* dollars. *D* and *X* Corporation agreed that the insurance proceeds would be used to redeem that portion of *D*'s stock equal in value to the insurance proceeds. The stock would be redeemed at a price determined by a formula contained in the agreement. Pursuant to this agreement *X* Corporation was irrevocably designated as beneficiary of the life insurance policy and had all incidents of ownership in the policy. *D* died in 1980.

X Corporation received the 50*x* dollars in insurance proceeds, and pursuant to the agreement used all of the proceeds to redeem forty percent of its shares.

LAW AND ANALYSIS

Section 2033 of the Internal Revenue Code provides that the value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of death. Section 20.2031-2(f) of the Estate Tax Regulations provides that, in valuing a decedent's closely held corporate stock, consideration shall be given to the proceeds of life insurance policies payable to or for the benefit of the company.

Section 2042(1) of the Code and section 20.2042-1(b)(1) of the regulations provide for the inclusion in the gross estate of the proceeds of insurance on the decedent's life receivable by or for the benefit of the decedent's estate.

In the instant case, since the redemption of part of the estate's stock in exchange for the payment of the insurance proceeds to the estate did not alter the estate's 100% ownership of *X* Corporation, *X* Corporation could be viewed as a mere conduit for payment of the insurance proceeds to the estate. Under this view, the insurance proceeds would be includible in *D*'s gross estate under section 2042(1) of the Code.

However, the Estate Tax Regulations consider the designation of *X* Corporation as beneficiary to be significant for purposes of determining whether the proceeds of the life insurance policy owned by *X* Corporation should be included in the gross estate of its sole shareholder under section 2042 of the Code. See section 20.2042-1(c)(6) of the regulations, which provides that a corporation's incidents of ownership are not attributed to the sole or controlling stockholder, if the proceeds are payable to the corporation. Rather, this regulation provides that in such situations the life insurance proceeds should be considered in determining the value of the decedent's stock that will be included in the gross estate under section 2033.

Estate of Huntsmen v. Commissioner, 66 T.C. 861 (1976), *acq.*, 1977-1 C.B. 1, presented a factual situation similar to this ruling. There, life insurance proceeds payable to two corporations were paid over pursuant to a redemption agreement to the estate of the sole stockholder of the two corporations. The Tax Court in *Huntsman* included the life insurance proceeds as a corporate asset in determining the value of the corporations' stock under section 2031 of the Code and section 20.2031-2(f) of the regulations.

HOLDING

The proceeds of the life insurance policy on the decedent's life should be reflected in the valuation of decedent's *X* Corporation stock, which is included in decedent's gross estate under section 2033 of the Code. The insurance proceeds are not separately included in the decedent's gross estate under section 2042.

26 CFR 20.2042-1: Proceeds of life insurance.

Whether survivor's loss benefit payable under a no-fault automobile insurance policy is proceeds of life insurance in which the decedent possessed incidents of ownership. See Rev. Rul. 82-5, page 131.

Part IV.—Taxable Estate

Section 2053.—Expenses, Indebtedness, And Taxes

26 CFR 20.2053-6: Deduction for taxes.

Whether the Canadian Capital Gains Tax imposed on Canadian property owned by the decedent qualifies for a foreign death tax credit under section 2014, or is deductible under section 2053. See Rev. Rul. 82-82, page 127.

Section 2055.—Transfers For Public, Charitable, And Religious Uses

26 CFR 20.2055-1: Deduction for transfers for public, charitable, and religious uses; in general. (Also Sections 6166, 6166A; 20.6166-1, 20.6166A-1.)

Bequests; residue; value. When expenses are payable out of the residuary estate, the value of the residuary charitable bequest must be reduced by an estimate of the maximum amount of interest that will be payable on federal estate taxes deferred under section 6166A of the Code to determine the amount of the charitable deduction allowable under section 2055. The charitable deduction must be reduced by the interest whether the deduction for this administration expense will be taken on the estate's income tax return or the federal estate tax return.

Rev. Rul. 82-6

ISSUE

In computing the amount of the estate tax charitable deduction under section 2055 of the Internal Revenue Code for a residuary charitable bequest, what reduction is to be made for interest payable on estate taxes deferred under section 6166A?

FACTS

D died testate on January 1, 1978. After certain specific bequests, *D* bequeathed the entire residue of the estate to charity. *D*'s will further provided that all debts, expenses and taxes are to be paid out of the residuary estate.

More than 35 percent of *D*'s gross estate consisted of the value of a closely held business. Therefore, the executor of the estate elected, under section 6166A of the Code, to make 10 annual installment payments of that portion of the federal estate tax liability that is attributable to the closely held business.

LAW AND ANALYSIS

Section 2055(a) of the Code provides that the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises or transfers, for exclusively religious, charitable, scientific, literary, or educational purposes. The amount deductible from the gross estate, however, may not be greater than the value of what charity is actually entitled to and does in fact receive.

If, under the terms of the will, the federal estate tax, or any estate, succession, legacy, or inheritance tax is payable out of property transferred to charity, section 2055(c) of the Code requires the value of the charitable bequest to be reduced by the amount of such taxes in determining the amount deductible from the gross estate. Similarly, if administration expenses are payable out of a bequest to charity, only the net amount received by charity is deductible by the decedent's estate. The reduction for administration expenses must be made whether the deduction for those expenses is taken on the estate tax return or on the estate's income tax return. See Rev. Rul. 73-98, 1973-1 C.B. 407.

The interest payable on the federal estate tax deferred under section 6166A of the Code is an administration expense, and, under the terms of *D*'s will, is payable out of *D*'s residuary estate. The residuary charitable bequest, therefore, must be reduced by an estimate of the maximum amount of interest that will be payable on the deferred estate tax over the 10 year period of deferment in order to determine the amount of the charitable deduction allowable under section 2055.

HOLDING

The value of *D*'s residuary charitable bequest must be reduced by an estimate of the maximum amount of interest that will be payable on federal estate taxes deferred under section 6166A of the Code to determine the amount of the charitable deduction allowable under section 2055. The charitable deduction must be reduced by the interest whether the deduction for this administration expense will be taken on the estate's federal income tax return or the federal estate tax return.

Section 6166A of the Code has been repealed by the Economic Recovery Tax Act of 1981, section 422(d), with respect to estates of decedents dying after December 31, 1981. Nevertheless, the conclusion of this revenue ruling applies as well when the payment of estate tax is extended under section 6166.

---

26 CFR 20.2055-2: Transfers not exclusively for charitable purposes.

Charitable remainder trust; death of life beneficiary; judicial reformation. Where judicial reformation of a testamentary charitable remainder trust is initiated after the life beneficiary's death and before the due date of the testator's return, the amount of the charitable deduction allowable under section 2055(a) is determined as if the trust provided for a 6 percent annuity. Rev. Rul. 76-545 clarified.

Rev. Rul. 82-97

ISSUE

What is the amount of the charitable deduction allowable under section 2055(a) of the Internal Revenue Code when a judicial reformation of a testamentary charitable remainder trust is initiated after the life beneficiary's death and before the testator's estate tax return due date?

FACTS

D died on January 14, 1980. Under the provisions of *D*'s will, executed in 1978, the residue of *D*'s estate is to be placed in a charitable remainder annuity trust from which an annuity of 5 percent of the initial fair market value of the trust corpus is to be paid to *B* with the remainder to a charitable organization described in section 2055(a) of the Code. *B* died on March 21, 1980. The charitable remainder trust did not meet the requirements of section 2055(e)(2), and on April 10, 1980, in accordance with section 2055(a)(3), an action was initiated to judicially reform the trust instrument to provide for a 5 percent annuity payable to *B* and a charitable interest qualified as an interest described in section 2055(e)(2). The reformation was completed on August 15, 1980. *D*'s executor deducted, under section 2055(a), the value of the charitable remainder interest passing under the judicially reformed instrument.

LAW AND ANALYSIS

Section 2055(a) of the Code provides, in part, that in determining the taxable estate of a decedent, there shall be deducted from the value of the gross estate the amount of all bequests, legacies, devises, or transfers to be used exclusively for certain religious, charitable, scientific, literary, or educational purposes.

Section 2055(e)(2)(A) of the Code

provides that in the case of decedents dying after December 31, 1969, no charitable deduction is allowable where an interest in property passes or has passed from the decedent for a charitable purpose, and an interest in the same property passes or has passed for a noncharitable purpose, unless in the case of a remainder interest, such interest is in the form of a charitable remainder annuity trust or a charitable remainder unitrust (described in section 664) or a pooled income fund (described in section 642(c)(5)).

Section 2055(e)(3) of the Code, as amended by section 301(a) of the Miscellaneous Revenue Act of 1980, Pub. L. 96-605, 1980-2 C.B. 702, 707, provides that in the event a charitable remainder interest created in a will executed before December 31, 1978, does not qualify for a deduction at the time of the decedent's death because the charitable interest (as described in section 2055(a)) does not meet the requirements of section 2055(e)(2), if certain conditions are satisfied a deduction will nevertheless be allowed. The governing instrument must be amended or conformed on or before December 31, 1981, or, if later, on or before the thirtieth day after the date on which judicial proceedings (which are required to amend or conform the governing instrument) begun on or before December 31, 1981, become final, so that the interest is in a trust described in section 2055(e)(2).

Section 2055(e)(3) of the Code also states that, if by the due date for the filing of an estate tax return (including any extension), the interest passes directly to a person or for a use described in section 2055(a), a deduction "shall be allowed as if the governing instrument was amended or conformed" under section 2055(e)(3).

Section 24.1(h) of the Temporary Estate Tax Regulations, 26 C.F.R. section 24.1 (1975), promulgated prior to enactment of the Miscellaneous Revenue Act of 1980, provides, in part:

> (1) In the case of a will executed before September 21, 1974,. . .that creates an interest for which a deduction would be allowable under section 2055(a) but for section 2055(e)(2)(A), if the date of death of the decedent is prior to January 1, 1976, and if on or before the filing date of the estate tax return (including any extension thereof)—
>
> (ii) Such interest passes directly to a person or for a use described in section 2055(a) (as, for example, by reason of the termination of an intervening interest), the governing instrument *shall be treated as if it were amended or conformed* pursuant to paragraph (a) of this section and a deduction shall be allowed. . . .(emphasis added).
>
> (2) The amount of the deduction for a transfer which is treated under this paragraph as if it were amended will be determined as if the transfer were a charitable remainder annuity trust which provides an annuity of six percent of the initial fair market value payable from the date of death—
>
> (i) In the case of a transfer providing a life estate, for the expected lives of the noncharitable beneficiaries as determined on the date of death of the decedent,. . .

The dates set out in section 24.1 of the temporary regulations have been implicitly extended to apply to the specified periods provided in later Congressional amendments of section 2055(e)(3) of the Code. See *Shriner's Hospital for Crippled Children v. U.S.*, 602 F.2d 302 (Ct.Cl. 1979).

Rev. Rul. 76-545, 1976-2 C.B. 289, holds that when the noncharitable beneficiary of a defective testamentary charitable remainder trust dies before the due date for the testator's estate tax return, the governing instrument is deemed amended or conformed under section 2055(e)(3) of the Code to meet the requirements of section 2055(e)(2).

In situations where the income beneficiary dies prior to the testator's estate tax return due date, judicial reformation of the governing instrument initiated after the income beneficiary's death will not alter the result provided in section 2055(e)(3) of the Code. A charitable deduction is allowed by section 2055(e)(3) because the governing instrument is treated as if it were amended or conformed to satisfy the requirements of section 2055(e)(2).

Consequently, in the instant case, the amount of the deduction is to be determined as if the transfer were to a charitable remainder annuity trust that provides an annuity of 6 percent of the initial fair market value of the trust corpus payable from the date of death of *D* for the expected life of *B* as determined on the date of death of *D*. See section 24.1(h) of the temporary regulations. The actual life expectancy of *B* cannot be used to value the charitable deduction unless the unusual circumstances described in Rev. Rul. 80-80, 1980-1 C.B. 194, are present.

HOLDING

Where judicial reformation of the governing instrument of a testamentary charitable remainder trust is initiated after the life beneficiary's death and before the testator's estate tax return due date (including any extension thereof), the amount of the charitable deduction allowable under section 2055(a) of the Code is determined as if the charitable remainder trust provided for a 6 percent annuity.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 76-545 is clarified.

Section 2056.—Bequests, etc. to Surviving Spouse

26 CFR 20.2056(b)-1: Marital deduction; limitation in case of life estate or other "terminable interest."
(Also Section 2032; 20.2032-1)

Marital deduction; "estate equalization clause;" alternate valuation date. Property passing to the decedent's spouse pursuant to an "estate equalization clause" qualifies for the marital deduction under section 2056 of the Code even though the clause allows for valuation of the spouse's estate on the alternate valuation date if elected for the estate of the decedent's.

Rev. Rul. 82-23

ISSUE

For purposes of section 2056 of the Internal Revenue Code, does property passing to a decedent's surviving spouse under an "estate equalization clause" qualify for the marital deduction if the clause allows for valuation of the surviving spouse's estate on the alternate valuation date, if that date is elected for the valuation of the decedent's estate?

FACTS

The decedent, *D*, created a revocable trust in 1970. Under the terms of the trust, at *D*'s death, a portion of the trust assets was to pass to *D*'s spouse under an "estate equalization clause." *D* died in 1981.

The "estate equalization clause" provided that the spouse would be deemed to have died shortly after *D* but on the same day. The executor was directed to distribute to the spouse that portion of the trust assets that would equalize *D*'s and the spouse's taxable estates, for federal estate tax purposes. In equalizing the estates, the spouse's estate was to be valued on the alternate valuation date if the executor elected alternate valuation for the decedent's estate under section 2032 of the Code. In valuing the estate the executor was to consider the value of the property owned by each spouse and the debts and expenses that would be attributed to each estate. The stated purpose of the clause was to obtain a marital deduction for *D*'s estate that would result in the lowest amount of federal estate taxes on *D*'s and the spouse's estate. The assets in the spouse's estate would be determined by the property owned by the spouse on the date of *D*'s death. Disposition of any of those assets or acquisition of any new assets would be ignored.

The executor determined that, on *D*'s date of death, the value of *D*'s estate (assets less debts and expenses) was $1,000,000 and the value of the spouse's estate (assets less debts and expenses) was $500,000. Neither *D* nor the spouse had made any taxable gifts. On the applicable alternate valuation date, the value of *D*'s estate was $1,000,000 and the value of the spouse's estate as $350,000.

To equalize the taxable estates to produce the lowest amount of federal estate tax, the executor used the alternate valuation date values. Property valued at $325,000 was distributed to the spouse, thereby increasing the value of the spouse's estate to $675,000. On the federal estate tax return filed for *D*'s estate, the executor reported a taxable estate of $675,000, having deducted $325,000 as the marital deduction from the decedent's estate of $1,000,000.

If the date of death values had been used, property valued at $250,000 would have been distributed to the spouse. The executor would have claimed a marital deduction of $250,000, and the values of the decedent's taxable estate and the spouse's taxable estate would have each been $750,000.

LAW AND ANALYSIS

Section 2056(a) of the Code allows a marital deduction for the value of any interest in property that is included in the decedent's gross estate and that passes from the decedent to the surviving spouse.

Section 2056(b) of the Code provides that certain terminable interests do not qualify for the marital deduction.

Section 20.2056(b)-1(b) of the Estate Tax Regulations provides that a "terminable interest" in property is an interest that will terminate or fail on the lapse of time or on the occurrence or the failure to occur of some contingency. Section 20.2056(b)-1(c) of the regulations provides that a property interest that is a terminable interest, as defined above, is nondeductible if another interest in the same property passed from the decedent to some other person for less than an adequate and full consideration in money or money's worth, and because it passed, the other person may possess or enjoy any part of the property after the termination or failure of the spouse's interest.

Section 2032(a) provides that the executor may elect to determine the value of the property included in the gross estate as of 6 months after the decedent's death. However, property distributed, sold, exchanged, or otherwise disposed of within 6 months after death must be valued as of the date of distribution, sale, exchange, or other disposition.

In *Jackson v. United States*, 376 U.S. 503 (1964), Ct. D. 1889, 1964-2 C.B. 522, the Court considered whether a 24-month support allowance awarded by the state court under California law qualified for the marital deduction. The Court held that the date of the decedent's death is the correct point of time to determine the nature of the spouse's interest for purposes of the terminable interest rule. As of the date of death, the widow's allowance was not indefeasibly vested. Instead, it was subject to termination or failure because (1) under California law, the spouse would not have been entitled to any allowance at all if the spouse had died or remarried before the allowance order was entered, and (2) the allowance, once ordered, would terminate on the spouse's death or remarriage during the 24 months. Accordingly, the allowance was a nondeductible terminable interest that did not qualify for the marital deduction.

In *Estate of Smith v. Commissioner*, 565 F. 2d 455 (7th Cir. 1977), *aff'g* 66 T.C. 415 (1976), *nonacq*. 1978-2 C.B. 4, the Service contended that the surviving spouse's interest in property passing to a marital trust under an "estate equalization clause" was a nondeductible terminable interest. Relying on *Jackson*, the Service contended that, because the executor was allowed to value the spouse's estate on the alternate valuation date, the spouse's interest in property passing under the clause was not indefeasibly vested until (1) the value of the spouse's estate had been ascertained on the alternate valuation date and (2) the trustee decided what property would be distributed to the marital deduction trust for the purpose of equalizing the taxable estates. On the decedent's date of death, it was not known whether any portion of the decedent's property would be distributed to the marital deduction trust because the value of the spouse's "estate" could have exceeded the value of the decedent's estate. The Service argued that spouse's interest in property passing under the "estate equalization clause" was contingent or subject to divestment upon an event, the valuation of the spouse's "estate," that would occur after the decedent's date of death. Therefore, the Service took the position that the spouse's interest passing under the clause was a terminable interest that, upon lapse or failure, would pass to others designated by the decedent.

The Tax Court held that the terminable interest rule, as stated in *Jackson*, did not apply to the "estate equalization clause" in *Smith*. The

Court found that in *Smith* the trustee's option to value the spouse's estate on the alternate valuation date affected the value of the interest passing under the "estate equalization clause" rather than its character. The court reasoned that, although the value of the interest in the marital deduction trust would remain unknown until a later time, the spouse was nevertheless indefeasibly vested in the interest in the trust upon the decedent's death. Therefore, the marital deduction was allowed for the property passing to the trust under the clause. The Court of Appeals, Seventh Circuit, affirmed the Tax Court and held that the spouse's interest was not a nondeductible terminable interest because the interest was vested and could not terminate after the decedent's death even though the value of the interest remained to be determined. *Accord, Estate of Laurin v. Commissioner*, 645 F.2d 8 (6th Cir. 1981), aff'g T.C.M. 1979-145 and *Estate of Meeske v. Commissioner*, 72 T.C. 78 (1979) *Acq.*, see page 1, this Bulletin.

The Internal Revenue Service will follow the decisions in *Smith, Laurin,* and *Meeske*, and will allow a marital deduction under section 2056 of the Code for property passing under an "estate equalization clause" in which the executor has an option to value the spouse's estate, for equalization purposes, on the alternate valuation date, if that is elected for the valuation of the decedent's estate. The Commissioner's nonacquiescence in *Smith* is withdrawn. See page 1, this Bulletin.

In the present situation, a marital deduction of $325,000 is allowable to *D*'s estate for property passing to spouse under the "estate equalization clause." The fact that the executor could value the spouse's estate on the alternate valuation date does not affect the allowance of the marital deduction.

HOLDING

For purposes of section 2056 of the Code, property passing to a surviving spouse under an "estate equalization clause" qualifies for the marital deduction even though the clause allows for valuation of the spouse's estate on the alternate date if elected for the decedent's estate.

Chapter 12.—Gift Tax
Subchapter A.—Determination of Tax Liability

Section 2503.—Taxable Gifts

26 CFR 25.2503-1: General definition of "taxable gifts" and of "total amount of gifts." (Also Section 2512; 25.2512-8.)

Medical expenses paid on behalf of another. The direct payment of unreimbursable medical expenses to the service provider by a donor on behalf of another is not subject to gift tax under section 2503(e) of the Code, effective for gifts made after December 31, 1981. Rev. Ruls. 54-343 and 73-612 amplified.

Rev. Rul. 82-98

ISSUE

For purposes of section 2503 of the Internal Revenue Code, as amended by section 441(b) of the Economic Recovery Tax Act of 1981 (ERTA), Pub. L. 97-34, 1981-2 C.B. 256, 333, to what extent, if any, are medical expenses and other payments made by the taxpayer-donor on behalf of another for reasons of love and affection subject to the gift tax under the circumstances described below?

FACTS

S, *D*'s adult son, was seriously injured in an automobile accident in 1982. During the period *S* was incapacitated in 1982, *D* paid *S*'s various medical expenses by checks made payable to the physician. During the year, *D* also paid the hospital for *S*'s hospital bills. These medical and hospital expenses were types described in section 213(e) of the Code and were not reimbursable by insurance or otherwise. Also, during the period of *S*'s disability, *D* made monthly payments to cover the mortgage on a residence owned by *S* and his spouse as joint tenants with rights of survivorship, which rights may be defeated by either party severing his or her interest. Under local law, the interests of joint tenants are presumed to be owned in equal shares. *D* was under no legal obligation to support *S* or *S*'s spouse.

LAW AND ANALYSIS

Subject to certain limitations and exceptions, a federal gift tax is imposed by section 2501(a) of the Code on gratuitous transfers of property and property interests by individuals. The amount of the gift represents the difference between the value of the property or property interest transferred and the value in money or money's worth of the consideration given in return. However, consideration in the form of love and affection is treated as having no monetary value and is wholly disregarded so that the entire value of the property or property interest transferred in return for it constitutes a gift. See section 25.2512-8 of the Gift Tax Regulations. The donor's taxable gifts with respect to any donee in any calendar year are determined by reducing the aggregate amount of gifts made to the donee during the calendar year first by certain allowable exclusions and then by allowable deductions.

For transfers made after December 31, 1981, section 2503(b) of the Code, as amended by ERTA, permits the donor to exclude the first $10,000 of gifts made to any donee during any calendar year provided, generally, that the gift is one of a present interest in the property transferred.

Rev. Rul. 54-343, 1954-2 C.B. 318, holds that payments of medical and hospital bills by a taxpayer for an adult child, as well as payments of living expenses on behalf of the child's family, constitute gifts for purposes of section 2501 of the Code, where there was no consideration for such payments other than love and affection.

Section 2503(e)(2)(B) of the Code, as added by ERTA and effective for transfers after December 31, 1981, provides that any direct, unreimbursed payment made by the donor on behalf of any individual to any person who provides medical care (as defined in section 213(e) of the Code) is not treated as a transfer of property by gift for purposes of the federal gift tax. Thus, medical expenses, such as those for medical insurance, diagnosis, and treatment that are paid directly by the donor to the service provider are not subject to the gift tax. On the other hand, where medical expenses are paid by the donee, payments by the donor to the donee to reimburse the donee (whether the payments are made by the donor before or after the donee pays the expenses) are subject to gift tax. See H.R. Rep. No. 97-201, 97th Cong., 1st Sess. 193-94 (1981), 1981-2 C.B. 352, 392, 393.

Because the medical and hospital bills paid in 1982 for *S* were medical expenses within the meaning of section 213(e) of the Code, and since they were paid directly by *D* to the person rendering the medical care, they are not treated as transfers subject to the gift tax.

In cases involving transfers prior to January 1, 1982, the holding in Rev. Rul. 54-343 continues to be applicable, subject to the limits on the annual exclusion provided in section 2503(b) of the Code, where such payments are made to the service provider. In addition, Rev. Rul. 54-343 continues to be applicable in cases where funds are distributed directly to the donee whether the transfer occurs before January 1, 1982, or after December 31, 1981.

Each monthly mortgage payment made by *D* constituted a gift of one-half the payment to *S* and one-half to *S*'s spouse. See Rev. Rul. 78-362, 1978-2 C.B. 248. These are gifts of present interests in property and are subject to the annual exclusion provided by section 2503 of the Code.

HOLDING

The entire amount expended by the donor with respect to the donee's medical and hospital bills is not subject to the gift tax under section 2503(e) of the Code. The result would be the same regardless of the relationship of the donee to the donor. Monthly mortgage payments made by the donor on behalf of the donor's adult child and spouse on a residence held by them as joint tenants with rights of survivorship are gifts of one-half to each, but qualify for the annual exclusion under section 2503(b) of the Code.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 54-343 is amplified.

Rev. Rul. 73-612 is amplified with respect to transfers occurring after December 31, 1981, to the extent it implies that unreimbursed payments for medical care paid to a service provider by a donor on behalf of a donee are subject to the federal gift tax.

Subchapter B.—Transfers

Section 2511.—Transfers in General

26 CFR 25.2511-1: Transfers in general.

Ct. D. 2012

SUPREME COURT
OF THE
UNITED STATES
No. 80-1614

George F. Jewett, Jr., et ux
v. Commissioner of Internal Revenue

[455 U.S. 305]

On Writ of Certiorari
to the United States
Court of Appeals for the Ninth Circuit

[February 23, 1982]

Syllabus

Argued December 1, 1981—Decided February 23, 1982

Held: The "transfer" referred to in the Treasury Regulation excepting from the federal gift tax a refusal to accept ownership of an interest in property transferred by will if such refusal is effective under local law and made "within a reasonable time after knowledge of the existence of the transfer," occurs, as indicated by both the text and history of the Regulation, when the interest is created and not at a later time when the interest either vests or becomes possessory. Hence, in this case where disclaimers of a contingent interest in a testamentary trust, though effective under local law, were not made until 33 years, and thus not "within a reasonable time," after the interest was created, the disclaimers were subject to a gift tax under §§2501(a)(1) and 2511(a) of the Internal Revenue Code, as indirect gifts to a successor in interest.

638 F.2d 93, affirmed.

STEVENS, J., delivered the opinion of the Court, in which BURGER, C. J., and BRENNAN, WHITE, MARSHALL, and POWELL, JJ., joined. BLACKMUN, J., filed a dissenting opinion, in which REHNQUIST and O'CONNOR, JJ., joined.

JUSTICE STEVENS delivered the opinion of the Court.

A trust beneficiary's refusal to accept ownership of property may constitute an indirect gift to a successor in interest subject to federal gift tax liability. 26 U.S.C. §§2501, 2511. Under Treasury Regulation 25.2511-1(c), however, such a refusal is not subject to tax if it is effective under local law and made "within a reasonable time after knowledge of the existence of the transfer." The petitioner in this case executed disclaimers of a contingent interest in a testamentary trust 33 years after that interest was created, but while it was still contingent. The narrow question presented is whether the "transfer" referred to in the regulation occurs when the interest is created, as the Government contends, or at a later time when the interest either vests or becomes possessory, as argued by petitioner.

Petitioner's grandmother, Margaret Weyerhaeuser Jewett, died in 1939 leaving the bulk of her substantial estate in a testamentary trust. Her will, executed in Massachusetts, provided that the trust income should be paid to petitioner's grandfather during his life, and thereafter to his parents. Upon the death of the surviving parent, the principal was to be divided "into equal shares or trusts so that there shall be one share for each child of my said son [petitioner's father] then living and one share for the issue then living representing each child of my said son then dead." App. 9. Petitioner's mother is the sole surviving life tenant. Thus, under the testamentary plan, if petitioner survived his mother, he would receive one share of the corpus of the trust; if he pre-deceased his mother, that share would be distributed to his issue. Since petitioner's parents had two children, his share of the trust amounted to one-half of the principal.

In 1972, when petitioner was 45 years old, he executed two disclaimers. The disclaimers each recognized that petitioner had "an interest in fifty percent (50%) of the trust estate. . .provided that he survives" his mother. App. 15. In the first disclaimer, petitioner renounced his right to receive

95% "of the aforesaid fifty percent (50%) of the remainder of the trust estate," *ibid.*; in the second he renounced his right to the remaining five percent. In 1972 the value of the trust exceeded $8 million.

Petitioner and his wife filed gift tax returns for the third and fourth quarters of 1972 in which they advised the Commissioner of the disclaimers, but did not treat them as taxable gifts.[1] The Commissioner assessed a deficiency of approximately $750,000. He concluded that the disclaimers were indirect transfers of property by gift within the meaning of §§2501(a)(1)[2] and 2511(a)[3] of the Internal Revenue Code, and that they were not excepted from tax under Treas. Reg. 25.2511-1(c)[4] because they were not made "within a reasonable time after knowledge" of his grandmother's transfer to him of an interest in the trust estate. Petitioner then filed this action in the Tax Court to recover the deficiency.

In the Tax Court and in the Court of Appeals, petitioner argued that at the time the disclaimers were made he had nothing more than a contingent interest in the trust, and that the "reasonable time" in which a tax-free disclaimer could be made did not begin to run until the interest became vested and possessory upon the death of the last surviving life tenant.[5] Although a comparable argument had been accepted by the Court of Appeals for the Eighth Circuit in *Keinath* v. *Commissioner of Internal Revenue*, 480 F.2d 57 (1973),[6] it was rejected by the Tax Court[7] and by the Ninth Circuit[8] in this case. We granted certiorari to resolve the conflict. ____ U.S. ____.

Petitioner relies heavily on the plain language of the Treasury Regulation and on early decisions that influenced its draftsmen. Before analyzing that language and its history, it is appropriate to review the statutory provisions that the regulation interprets.

I

Section 2501(a)(1) of the Internal Revenue Code imposes a tax "on the transfer of property by gift." Section 2511(a) provides that the tax shall apply "whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible." As the Senate[9] and House[10] Reports explain:

> "The terms 'property,' 'transfer,' 'gift,' and 'indirectly' are used in the broadest and most comprehensive sense; the term 'property' reaching every species of right or interest protected by law and having an exchangeable value."

In *Smith* v. *Shaughnessy*, 318 U.S. 176, 180, the Court noted that "[t]he language of the gift tax statute, 'property. . .real or personal, tangible or intangible,' is broad enough to include property, however conceptual or contingent."

Our expansive reading of the statutory language in *Smith* unquestionably encompasses an indirect transfer, effected by means of a disclaimer, of a contingent future interest in a trust.[11] Congress enacted the gift tax as a "corollary" or "supplement" to the estate tax.[12] In *Estate of Sanford* v. *Commissioner*, 308 U.S. 39, 44, the Court explained that "[a]n important, if not the main, purpose of the gift tax was to prevent or compensate for avoidance of death taxes by taxing the gifts of property *inter vivos* which, but for the gifts, would be subject in its original or converted form to the tax laid upon transfers at death." Since the practical effect of petitioner's disclaimers was to reduce the expected size of his taxable estate and to confer a gratuitous benefit upon the natural objects of his bounty, the treatment of the disclaimers as taxable gifts is fully consistent with the basic purpose of the statutory scheme.

---

[1] Petitioner's wife, Lucille M. Jewett, elected to consent to treat the gifts made by her husband as having been made by both husband and wife to the extent allowed by law. App. to Pet. for Cert. A-20.

[2] "A tax, computed as provided in section 2502, is hereby imposed for each calendar quarter on the transfer of property by gift during such calendar quarter by any individual, resident or nonresident." 26 U.S.C. §2501(a)(1).

[3] "Subject to the limitations contained in this chapter, the tax imposed by section 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible; but in the case of a nonresident not a citizen of the United States, shall apply to a transfer only if the property is situated within the United States." 26 U.S.C. §2511(a).

[4] "The gift tax also applies to gifts indirectly made. Thus, all transactions whereby property or property rights or interests are gratuitously passed or conferred upon another, regardless of the means or device employed, constitute gifts subject to tax. See further §25.2512-8. Where the law governing the administration of the decedent's estate gives a beneficiary, heir, or next-of-kin a right to completely and unqualifiedly refuse to accept ownership of property transferred from a decedent (whether the transfer is effected by the decedent's will or by the law of descent and distribution of intestate property), a refusal to accept ownership does not constitute the making of a gift if the refusal is made within a reasonable time after knowledge of the existence of the transfer. The refusal must be unequivocable [sic] and effective under the local law. There can be no refusal of ownership of property after its acceptance. Where the local law does not permit such a refusal, any disposition by the beneficiary, heir, or next-of-kin whereby ownership is transferred gratuitously to another constitutes the making of a gift by the beneficiary, heir, or next-of-kin. In any case where a refusal is purported to relate to only a part of the property, the determination of whether or not there has been a complete and unqualified refusal to accept ownership will depend on all of the facts and circumstances in each particular case, taking into account the recognition and effectiveness of such a purported refusal under the local law. In the absence of facts to the contrary, if a person fails to refuse to accept a transfer to him of ownership of a decedent's property within a reasonable time after learning of the existence of the transfer, he will be presumed to have accepted the property. In illustration, if Blackacre was devised to A under the decedent's will (which also provided that all lapsed legacies and devises shall go to B, the residuary beneficiary), and under local law A could refuse to accept ownership in which case title would be considered as never having passed to A, A's refusal to accept Blackacre within a reasonable time of learning of the devise will not constitute the making of a gift by A to B. However, if a decedent who owned Greenacre died intestate with C and D as his only heirs, and under local law the heir of an intestate cannot, by refusal to accept, prevent himself from becoming an owner of intestate property,-any gratuitous disposition by C (by whatever term it is known) whereby he gives up his ownership of a portion of Greenacre and D acquires the whole thereof constitutes the making of a gift by C to D." Treas. Reg. 25.2511-1(c); 26 CFR 25.2511-1(c) (1981).

[5] As did the Tax Court, we assume that petitioner's interest in the trust is properly characterized as a contingent remainder. Although that interest is arguably a vested remainder subject to divestiture, the distinction is not one of substance for our purposes here. Cf. *Helvering* v. *Hallock*, 309 U.S. 106.

[6] In *Keinath*, the court applied "the prevailing common law rule" and held that the holder of a vested remainder interest subject to divestiture has a reasonable time after the death of the life beneficiary within which to renounce or disclaim the remainder without tax consequences. 480 F.2d, at 64. The court emphasized that the holder of the remainder interest did not obtain a right to beneficial ownership and control of the property until the death of the life beneficiary. *Ibid*.

[7] 70 T.C. 430 (1978).

[8] 638 F.2d 93 (CA9 1980).

[9] S. Rep. No. 665, 72d Cong., 1st Sess. 39 (1932).

[10] H.R. Rep. No. 708, 72d Cong., 1st Sess. 27 (1932).

[11] The actual value of the interest will be affected by the fact that it is not indefeasibly vested. As the Tax Court noted in this case:

"The value of petitioner's remainder interest was not, of course, equal to 50 percent of the value of the trust corpus. Rather, it depended upon actuarial factors reflecting the various contingencies." 70 T.C., at 435 n. 3.

[12] The Committee Reports state that the gift tax was designed "to impose a tax which measurably approaches the estate tax which would have been payable on the donor's death had the gifts not been made and the property given had constituted his estate at his death. The tax will reach gifts not reached, for one reason or another, by the estate tax." H.R. Rep. No. 708, 72d Cong., 1st Sess. 28 (1932); S. Rep. No. 655, 72d Cong., 1st Sess. 40 (1932).

II

The controlling Treasury Regulation provides that a refusal to accept ownership of property transferred from a decedent does not constitute a gift if two conditions are met. First, the refusal must be effective under the law governing the administration of the decedent's estate. Second, the refusal must be made "within a reasonable time after knowledge of the existence of the transfer."

There is no dispute in this case that the first requirement has been satisfied; the disclaimers were effective under Massachusetts law. The controversy arises from the second requirement; specifically, it is over the meaning of the word "transfer," which may be read to refer to the creation of petitioner's remainder interest by his grandmother's will, or to either the vesting of that interest or the distribution of tangible assets upon the death of the life tenant. Both positions find support in the language of the regulation.

To a layman the word "transfer" would normally describe a change in ownership of an existing interest rather than the creation of a new interest. Moreover, the reference to a transfer of "ownership of a decedent's property" suggests that the transferee must acquire property that once had been owned by the decedent; petitioner's grandmother never owned the future interests that her will created, but she once did own the assets (or their equivalent) that the remaindermen will acquire when their interests become possessory in character. Thus, language in the regulation implies that the relevant "transfer" had not yet occurred when petitioner renounced his interest in the trust.

Other language, however, indicates that the relevant "transfer" occurs at the time of the testator's death. The word "transfer" is the basic term used in the gift tax provisions to describe *any* passage of property without consideration that may have tax consequences. See 26 U.S.C. §§2501, 2511, *supra*, nn. 2, 3.[13] The regulation describes a transfer that "is effected by the decedent's will" (or by the law of descent and distribution of intestate property), not by a subsequent vesting event or distribution of property. The property must be transferred "from a decedent," not from an estate executor or trust administrator. The lack of any reference in the regulation to future interests or contingent remainders, and the consistent focus on transfers effected by the decedent by will or through the laws of intestate distribution, undermines the suggestion that the relevant transfer occurs other than at the time of the testator's death. The regulation also requires "knowledge of the existence of the transfer"; since a person to whom assets have actually been distributed would seldom, if ever, lack knowledge of the existence of such a transfer, it seems more likely that this provision was drafted to protect persons who had no knowledge of the creation of an interest.

On balance, we believe that the text of the regulation supports the Commissioner's interpretation. Because that text is not entirely clear, however, it is appropriate to examine briefly the regulation's history.

III

Treas. Reg. 25.2511-1(c) has not been changed since it was promulgated on November 15, 1958. The form of the regulation, however, is somewhat different from a draft that was first proposed on January 3, 1957. That draft required a renunciation to be made "within a reasonable time after knowledge of the existence of the interest," rather than after knowledge of the existence of the "transfer."[14] The word "interest" unquestionably would encompass a contingent remainder even if the word "transfer" arguably would not. Thus, if the initial draft had been adopted without change, petitioner's disclaimers certainly would be subject to tax. Petitioner contends that the drafting change must have been intended to avoid this consequence.

An assessment of petitioner's argument requires an examination of the reason for the change in the regulation's language. The explanation of the change rendered by the Commissioner in 1958 indicates that it was intended to accomplish a purpose quite different from that suggested by petitioner.

A Memorandum from the Commissioner to the Secretary of the Treasury submitted on October 1, 1958 explained that the change in language was intended to capture "the proper distinction" between two early court decisions that the regulation had attempted to codify.[15] In both of these cases the transferee had renounced a fee interest before the administration of the decedent's estate had been completed. In the earlier case, *Brown* v. *Routzahn*, 63 F.2d 914 (CA6 1933), *cert. den.* 290 U.S. 641, a husband refused to accept a bequest under his wife's will. Under Ohio law the disclaimer was effective because it preceded the distribution of his wife's estate. Since the husband had never acquired ownership of the property, his disclaimer was held not to constitute the transfer of an interest; rather, it was deemed an exercise of a right to refuse a gift of property. Accordingly, the renunciation was held not to be a gift in contemplation of death for purposes of determining the husband's estate tax. In the second case, *Hardenbergh* v. *Commissioner of Internal Revenue*, 198 F.2d 63 (CA8 1952), *cert. den.* 344 U.S. 836, the decedent died intestate leaving a wife, a daughter, and a son by a prior marriage. To effectuate the decedent's intent to equalize the wealth of the three, the wife and daughter relinquished their rights to their intestate shares.

---

[13] Petitioner does not contend that the creation of an irrevocable trust for the benefit of alternate contingent remaindermen is not a "transfer" when made; if the creation of such a trust is a "transfer" of property within the meaning of the statute, a "transfer" occurred in this case at Margaret Weyerhaeuser Jewett's death. In short, the use of the word "transfer" in Treas. Reg. 25.2511-1(c) is not indicative of special meaning. To the contrary, Congress has specifically indicated that the term "transfer," at least as used in the statutory provisions defining the gift tax, is used "in the broadest and most comprehensive sense." See p. 5, *supra*, and nn. 9, 10. It is not surprising that the draftsmen of the regulation would choose the general term utilized by Congress to describe any passage of property with possible tax consequences.

[14] The January 3, 1957 draft of the regulation provided, in part:
"The renunciation of a vested property interest, such as the interest of an heir or next-of-kin, or devisee in whom title immediately vests upon a decedent's death under local law, constitutes a gift to those persons who receive the property interest by means of the renunciation. On the other hand the renunciation of a gift, bequest, or inheritance, if under local law title does not immediately vest, is not a gift if the renunciation is complete, and is made within a reasonable time after knowledge of the existence of the interest." 22 Fed. Reg. 58 (1957).

[15] The Memorandum is published in XIII *Tax Notes* 203 (July 27, 1981).
In pertinent part, the Memorandum explains:
"In what was intended to be the application of the rules in *Brown v. Routzahn* (1933) 63 F.2d 914, cert. denied 290 U.S. 641, and *Hardenbergh* v. *Commissioner* (1952) 198 F.2d 63, cert. denied 344 U.S. 836, it was stated that where title to the property did not vest in the benefi-

Under Minnesota law, however, "title to an interest in decedent's estate vested in the taxpayers by operation of law which neither had the power to prevent." 198 F.2d, at 66. Since local law denied them the power to renounce the interest, the taxpayers' disclaimers were not effective and constituted gifts subject to the federal gift tax.

As indicated in the Commissioner's Memorandum, Treas. Reg. 25.2511-1(c) sought to preserve the distinction between these two cases. Originally, the regulation tracked language in the *Hardenbergh* opinion and provided that a disclaimer was taxable only if title to the property had "vested" under state law. On consideration, however, the Commissioner recognized that this language did not capture "the proper distinction between these two court cases"; indeed, in *Brown* v. *Routzahn*, the property interest had fully "vested" at the time of the taxpayer's renunciation.[16] Thus, to incorporate the proper distinction, the Commissioner changed the "vesting requirement to a requirement that "the law governing the administration of the decedent's estate" must give a right to "refuse to accept ownership of property transferred from a decedent." Having eliminated the "vested property interest" language from the first part of the regulation, the Commissioner correspondingly changed the second part to read "within a reasonable time after knowledge of the existence of the transfer," rather than "within a reasonable time after knowledge of the existence of the interest."

Thus, the purpose of the change in the regulation was not to exclude contingent remainders. Neither *Brown* nor *Hardenbergh* concerned contingent interests. Since the original draft of the regulation supports the government's position in this case, and since the change in its form was made for a reason that is unrelated to the issue presented, the regulation's history buttresses the government's position.

Petitioner also contends that the history of the regulation demonstrates that its draftsmen merely intended to codify the rules of *Brown* v. *Routzahn* and *Hardenbergh* v. *Commissioner*, and that under those cases state law controlled both the "right" to renounce and the "timeliness" of the renunciation. Although petitioner accurately interprets these two cases, his interpretation of the regulation would render half of its superfluous. The regulation explicitly imposes two requirements: (1) the disclaimer must be effective as a matter of local law; and (2) the disclaimer must be made within a reasonable time. If timeliness were governed solely by local law, the second requirement would be redundant. While it is possible that local law may require a disclaimer to be timely to be effective, such a requirement would not absolve the taxpayer from the separate timeliness requirement imposed by the federal regulation. Otherwise, the regulation would be complete with a single requirement that the disclaimer be effective under local law.[17]

IV

Petitioner's remaining arguments may be answered quickly. In the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1], Congress established specific standards for determining whether a disclaimer constitutes a taxable gift; those new standards would support the Commissioner's position in this case if the disclaimers had been executed after the effective date of the Act.[18] Petitioner argues that the legislative decision not to apply those standards retroactively is evidence that a different rule was

---

ciary or heir immediately upon the decedent's death, the renunciation of the property did not constitute the making of a gift, but that where title vested in the beneficiary or heir immediately upon the decedent's death, the act of the beneficiary or heir in giving up what passed to him from the decedent constituted the making of a gift. . . . Protests on these provisions were received. After reviewing these protests, we have reconsidered our position and now believe that the proper distinction between these two court cases turns on the question of whether under the applicable State law a beneficiary or heir can or cannot refuse to accept ownership of the property which passed from the decedent. Accordingly, we have revised paragraph (c) of section 25.2511-1 to reflect this change of position."

[16] As the court stated in that case:

"The [taxpayer] was in possession of the estate from 1912 until it was transferred to the trustees in 1920. It was not, however, in his possession as donee, but as a coexecutor. Nevertheless, at any time within that period he could have taken the one-third or made a renunciation that would have estopped him from claiming it. He did neither. It may be conceded, too, we think, that, had he died at any time between 1912 and the date of the distribution, this property would have passed under a general devise in his will, or, leaving no will, would have passed under the laws of descent and distribution as a part of his estate." 63 F.2d, at 916.

[17] It is possible that the federal timeliness requirement was added in response to the particular facts presented by *Brown* v. *Routzahn*, *supra*, in which the taxpayer waited eight years to renounce the interest and did so when he was 72 years old. Although the renunciation was timely as a mater of Ohio law, the Treasury Department may well have thought that such delay was unacceptable for federal tax purposes. In practical effect, the eight year delay made it likely that the renunciation decision was part of the taxpayer's personal estate planning. As explained by the Tax Court in this case:

"While a State court might be willing to accept a renunciation of a nonpossessory and not indefeasibly vested property interest after the passage of considerable time, so long as the interests of third parties have not been harmed, the passage of time is crucial to the scheme of the gift tax. With time, the potential recipient can wait to see if he himself needs the property, or whether he had better let it pass directly to the next generation." 70 T.C., at 437.

[18] See Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1893 [1976-3 C.B. (Vol. 1) 1,368], §2009(b); 26 U.S.C. §2518(b).

previously effective. It is clear, however, that Congress expressed no opinion on the proper interpretation of the regulation at issue in this case; it merely established an unambiguous rule that should apply in the future.[19]

Petitioner also argues that it is unfair to apply the 1958 regulation "retroactively" to an interest that had been created previously; petitioner asserts that, by the time the regulation was adopted, it was already too late—according to the Commissioner's view—to disclaim the interest.[20] The argument lacks merit. It is based on an assumption that petitioner had a "right" to renounce the interest without tax consequences that was "taken away" by the 1958 regulation. Petitioner never had such a right. Indeed, petitioner does not argue that taxation of the disclaimers is inconsistent with the statutory provisions imposing a gift tax, which were enacted long before petitioner's interest in the trust was created. The 1958 regulation was adopted well in advance of the disclaimers in this case; we see no "retroactivity" problem.

Finally, petitioner argues that the disclaimer of a contingent remainder is not a taxable event by analogizing it to an exercise of a special power of appointment, which generally is not considered a taxable transfer. 26 U.S.C. §2514. As the Commissioner notes in response, however, a disclaimant's control over property more closely resembles a *general* power of appointment, the exercise of which is a taxable transfer. *Ibid.* Unlike the holder of a special power—but like the holder of a general power—a disclaimant may decide to retain the interest himself. It is this characteristic of the control exercised by a disclaimant that makes a disclaimer a "transfer" within the scope of the gift tax provisions.

V

The Commissioner's interpretation of the regulation has been consistent over the years and is entitled to respect. This canon of construction, which generally applies to the Commissioner's interpretation of the Internal Revenue Code, see *Commissioner* v. *Portland Cement Co. of Utah*, 450 U.S. 156, 169, [Ct. D. 2004, 1981-1 C.B. 378] is even more forceful when applied to the Commissioner's interpretation of his own regulation.

Since the relevant "transfer" in this case occurred when petitioner's grandmother irrevocably transferred her assets to a testamentary trust, petitioner's disclaimers of the rights created by that trust were not made within a reasonable time. Even accepting petitioner's argument that the clock did not begin to run until he reached the age of majority, the disclaimers were made after the passage of 24 years. As the Tax Court explained:

> "The petitioner possessed, for 24 years, the effective right to determine who should ultimately receive the benefits of a 50-percent remainder interest of a trust which, in 1972, had a corpus of approximately $8 million. He waited to act in respect of that remainder interest until the surviving life beneficiary was over 70 years of age and until he himself was 45 and, it appears, a man of substantial means. In 1972, by the execution of two disclaimers, he elected to let the property pass according to the alternative provisions of his grandmother's will—to the natural objects of his bounty. This, we hold, was an exercise of control over the disposition of property subject to the gift tax imposed by section 2501." 70 T.C., at 438 (footnote omitted).

We agree. The Commissioner's assessment of a tax was proper, both under the statute and the regulation.

The judgment of the Court of Appeals is affirmed.

Section 2512.—Valuation of Gifts

26 CFR 25.2512-8: Transfer for insufficient consideration.

Whether payments made by a donor in payment of medical expenses incurred by another and in payment of another's mortage liability are subject to the gift tax. See Rev. Rul. 82-98, page 141.

Chapter 13.—Tax on Certain Generation-Skipping Transfers
Subchapter A.—Tax Imposed

Section 2601.—Tax Imposed

26 CFR 26.2601-1: Effective date.

Generation-skipping transfer; addition to trust; valuation date. The date for valuing an addition to a trust, for purposes of the Generation-Skipping Transfer Tax, is the date the will or trust provision requiring the addition becomes effective.

Rev. Rul. 82-36

ISSUE

What is the date for valuing an addition to a trust that was irrevocable on June 11, 1976, for purposes of determining the portions of subsequent generation-skipping transfers from the trust that are subject to the generation-skipping transfer tax under section 2601 of the Internal Revenue Code?

FACTS

A, the spouse of the decedent, *D*, died in 1968. Under the terms of *A*'s will, Trust *1* was created for the benefit of *D*. *D* had a lifetime right to the income from Trust *1* and a testamentary general power of appointment over the corpus. If *D* did not exercise the power of appointment, the Trust *1* corpus was to pass to another trust, Trust *2*. Trust *2* was created by *A* for the benefit of *D*'s and *A*'s children, grandchildren, and great-grandchildren.

D died intestate on January 23, 1981. The value of the Trust *1* corpus was included in *D*'s gross estate as property subject to *D*'s general power of appointment. Because *D* did not exercise the power of appointment, the Trust *1* corpus was added to Trust *2*. With respect to *D* at death, Trust *2* was a generation-skipping trust for purposes of section 2601 of the Code.

---

[19] After noting the decision in *Keinath* v. *Commissioner of Internal Revenue*, 480 F.2d 57 (CA8 1973), and the "reasonable" time requirement of the regulation, the House Report states that Congress "believe[d] that definitive rules concerning disclaimers should be provided for estate and gift tax purposes to achieve uniform treatment. In additional, [Congress] believe[d] that a uniform standard should be provided for determining the time within which a disclaimer must be made." H.R. Rep. No. 1380, 94th Cong., 2d Sess. 66-67 (1976) [1976-3 C.B. (Vol. 3) 735].
Nothing in the legislative history expresses an opinion on the proper interpretation of the previously controlling regulation. Nor is such an opinion indicated by the mere enactment of the law; Congress may seek to clarify the future without affecting the past. Cf. *Knetsch* v. *United States*, 364 U.S. 361, 367-370 [Ct. D. 1858, 1961-1 C.B. 34].

[20] Petitioner's argument would have more appeal had he attempted to renounce the interest immediately after the adoption of the 1958 regulation, rather than some 14 years later.

On the date of *D*'s death, the value of the Trust *1* corpus was $500,000. On the date of distribution to Trust *2*, the value of the Trust *1* corpus was $400,000. The value of the Trust *2* property, without the addition, was $500,000 on both *D*'s date of death and the date of distribution.

LAW AND ANALYSIS

Section 2601 of the Code imposes a tax on every geneation-skipping transfer from a generation-skipping trust. However, under the effective date rule, the tax does not apply to a transfer from a trust that was irrevocable on June 11, 1976, to the extent that the transfer is made out of corpus held in the trust on June 11, 1976. Section 26.2601-1(b) of the Generation-Skipping Transfer Tax Regulations.

Under section 26.2601-1(e)(1) of the regulations, an addition made after June 11, 1976, to the corpus of a trust that was irrevocable on June 11, 1976, will generally subject a proportionate amount of the transfers from the trust to the generation-skipping transfer tax. In such a case, the portion of transfers subject to the tax is a fraction of the trust's total value. The fraction is:

$$\frac{\text{Amount of the addition (valued as of the date the addition was made)}}{\text{Total value of the trust immediately after the addition}}$$

In the present situation, because 1) the Trust *1* corpus passed to Trust *2* when *D* died intestate and failed to exercise the testamentary general power of appointment and 2) *D*'s possession of the power at death resulted in a taxable transfer under the federal estate tax laws, the amount of Trust *1* corpus is a post-June 11, 1976, addition to Trust *2 for purposes of the generation-skipping transfer tax. Further, D* is treated as the grantor of the addition. Section 26.2601-1(e)(3) and Example 13 of section 26.2601-1(e)(7) of the regulations. Because *A* created and funded the irrevocable trust before June 11, 1976, no part of the generation-skipping transfers attributable to *A*'s contributions is subject to the generation-skipping transfer tax.

The date the addition is made, for federal estate and generation-skipping transfer tax purposes, is the effective date of the transfer to Trust *2*. In this case, the effective date of the transfer is January 23, 1981, the date of *D*'s death, at which time *A*'s will provision requiring the transfer became operative. Therefore, under section 2601 of the Code, the date the addition was made and, thus, the date for determining the value of the addition is January 23, 1981. *Cf.* section 2031 of the Code providing that the value of the gross estate is the value of all includible property at the time of death. Consequently, for purposes of determining the portions of subsequent generation-skipping transfers from the trust that are subject to the generation-skipping transfer tax, under section 26.2601-1(e)(1), the value of the addition on the date of distribution is disregarded, and the amount of the addition is valued as of *D*'s date of death. *Cf.* Rev. Rul. 80-123, 1980-1 C.B. 205, holding that a trust is deemed created on the settlor's date of death, for purposes of section 2055 of the Code, even though the trust is funded on a later date. In this case, the numerator of the fraction is $500,000, the value of the addition on *D*'s date of death. The denominator is $1,000,000, the value of the Trust *2* assets immediately after the addition was made. Thus, 50 percent (500,000/1,000,000) of each transfer made pursuant to the trust after January 23, 1981, will be subject to the Generation-Skipping Transfer Tax.

HOLDING

In determining the portions of subsequent generation-skipping transfers that are subject to the Generation-Skipping Transfer Tax under section 2601 of the Code, in circumstances such as set forth above, the date for valuing an addition to a trust that was irrevocable on June 11, 1976, is the date the will or trust provision, requiring the transfer to the generation-skipping trust, becomes effective. Further, the result would be the same in situations where alternate valuation, as provided under section 2032, is elected for the grantor's estate.

---

26 CFR 26.2601-1: Effective date.

T.D. 7812

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER B, PART 26.—GENERATION-SKIPPING TRANSFER TAX REGULATIONS

Effective date provisions for generation-skipping transfer tax.

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final rule.

SUMMARY: This document modifies portions of the existing regulations relating to the generation-skipping transfer tax by extending the effective date to January 1, 1983. The regulations reflect the change made by the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256] and affect those persons subject to the transitional rules under section 2601 of the Internal Revenue Code of 1954 (Code).

DATES: The regulations are effective for certain generation-skipping transfers (as defined in section 2611(a) of the Code) made after June 11, 1976.

FOR FURTHER INFORMATION CONTACT: Fred E. Grundeman of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. Attention CC:LR:T 202-566-3287, not a toll-free number.

SUPPLEMENTARY INFORMATION:

BACKGROUND

Under Chapter 13 of the Code, a tax is imposed on every generation-skipping transfer occurring after June 11, 1976. However, section 2006(c) of the Tax Reform Act of 1976 (P.L. 94-455, [1976-3 C.B. (Vol. 1) 1, 365] 90 Stat. 1889, as amended by section 702(n) of the Tax Reform Act of 1978 (P.L. 95-

600, [1978-3 C.B. 1, 169] 92 Stat. 2035)) provided a transitional rule whereby certain trusts in existence on that date (or created under wills in existence on that date) were excluded from the application of the tax if the grantor (or testator) died before January 1, 1982. Section 428 of the Economic Recovery Tax Act of 1981 (P.L. 97-34, [1981-2 C.B. 256, 333] 95 Stat. 319) extended that date to January 1, 1983.

The purpose of this regulation is to amend the existing regulation to reflect the new transition rule date.

Because this regulation is liberalizing in nature, it is found unnecessary to issue this Treasury decision with notice and public procedure.

DRAFTING INFORMATION

The principal author of these regulations is Fred E. Grundeman of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and the Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 26 is amended as follows:

Paragraph. Section 26.2601-1 is revised as follows:

a. By removing the year "1982" and inserting, in its place, the year "1983" in the following places:

1. Section 26.2601-1(b)(1)(ii), and (2);

2. Section 26.2601-1(e)(2), (3), (4), and

3. Section 26.2601-1(e)(7), examples (3), (7), (8), (9), (10), (11), (12) and (13); and

b. By removing the year "1981" and inserting, in its place, the year "1982" in the following places:

1. Section 26.2601-1(b)(3), example (3); and

2. Section 26.2601-1(e)(7), examples (7), (8), (10) and (11).

Because this regulation is liberalizing in nature it is found unnecessary to issue it with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

ROSCOE L. EGGER, JR.,
Commissioner of
Internal Revenue.

Approved February 24, 1982.

JOHN E. CHAPOTON,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on March 2, 1982, 8:45 a.m., and published in the issue of the Federal Register for March 3, 1982, 47 F.R. 8995)

Subtitle C.—Employment Taxes
Chapter 21.—Federal Insurance Contributions Act
Subchapter A.—Tax on Employees

Section 3102.—Deduction of Tax From Wages

Ct. D. 2011

SUPREME COURT OF
THE UNITED STATES

No. 80-767

UNITED STATES, APPELLANT

v. EDWIN D. LEE

[455 U.S. 252]

ON APPEAL FROM
THE UNITED STATES
DISTRICT COURT FOR
THE WESTERN DISTRICT
OF PENNSYLVANIA

[February 23, 1982]

Syllabus

No. 80-767. Argued November 2, 1981—Decided February 23, 1982

Appellee, a self-employed farmer and carpenter, is a member of the Old Order Amish, which believe that there is a religiously based obligation to provide for their fellow members the kind of assistance contemplated by the social security system. During certain years when he employed other Amish to work on his farm and in his carpentry shop, appellee failed to withhold social security taxes from his employees or to pay the employer's share of such taxes because he believed that payment of the taxes and receipt of benefits would violate the Amish faith. After the Internal Revenue Service assessed him for the unpaid taxes, appellee paid a certain amount and then sued in Federal District Court for a refund, claiming that imposition of the taxes violated his First Amendment free exercise of religion rights and those of his employees. The District Court held the statutes requiring appellee to pay social security taxes unconstitutional as applied, basing its holding on both 26 U.S.C. §1402(g), which exempts from social security taxes, on religious grounds, self-employed Amish and others, and the First Amendment.

Held:

1. The exemption provided by §1402(g), being available only to self-employed individuals, does not apply to employers or employees, and hence appellee and his employees are not within its provisions.

2. The imposition of social security taxes is not unconstitutional as applied to such persons as appellee who object on religious grounds to receipt of public insurance benefits and to payment of taxes to support public insurance funds.

(a) While there is a conflict between the Amish faith and the obligations imposed by the social security system, not all burdens on religion are unconstitutional. The state may justify a limitation on religious liberty by showing that it is essential to accomplish an overriding governmental interest.

(b) Widespread individual voluntary coverage under social security would undermine the soundness of the social security system, and would make such system almost a contradiction in terms and difficult, if not impossible, to administer.

(c) It would be difficult to accommodate the social security system with myriad exceptions flowing from a wide variety of religious beliefs such as the Amish. *Wisconsin* v. *Yoder*, 406 U.S. 205, distinguished. There is no principled way for purposes of this case to distinguish between general taxes and those imposed under the Social Security Act. The tax system could not function if denominations were allowed to challenge it because tax payments were spent in a manner that violates their religious belief. Because the broad public interest in maintaining a sound tax system is of such a high order, religious belief in conflict with the payment of taxes affords no basis for resisting the tax.

(d) Congress in §1402(g) has accommodated, to the extent compatible with a comprehensive national program, the practices of those who believe it a violation of their faith to participate in the social security system. When followers of a particular sect enter into commercial activity as a matter of choice, the limits they accept on their own conduct as a matter of conscience and faith are not to be superimposed on the statutory schemes that are binding on others in that activity. Granting an exemption from social security taxes to an employer operates to impose the employer's religious faith on the employees. The tax imposed on employers to support the social security system must be uniformly applicable to all, except as Congress explicitly provides otherwise.

497 F. Supp. 180, reversed and remanded.

BURGER, C. J., delivered the opinion of the Court, in which BRENNAN, WHITE, MARSHALL, BLACKMUN, POWELL, REHNQUIST, and O'CONNOR, JJ., joined. STEVENS, J., filed an opinion concurring in the judgment

CHIEF JUSTICE BURGER delivered the opinion of the Court.

We noted probable jurisdiction to determine whether imposition of social security taxes is unconstitutional as applied to persons who object on religious grounds to receipt of public insurance benefits and to payment of taxes to support public insurance funds. ____ U.S. ____ (1981). The District Court concluded that the Free Exercise Clause prohibits forced payment of social security taxes when payment of taxes and receipt of benefits violates the taxpayer's religion. We reverse.

I

Appellee, a member of the Old Order Amish, is a self-employed farmer and carpenter. From 1970 to 1977, appellee employed several other Amish to work on his farm and in his carpentry shop. He failed to file the quarterly social security tax returns required of employers, withhold social security tax from his employees or pay the employer's share of social security taxes.[1]

In 1978, the Internal Revenue Service assessed appellee in excess of $27,000 for unpaid employment taxes; he paid $91 – the amount owed for the first quarter of 1973 – and then sued in the United States District Court for the Western District of Pennsylvania for a refund, claiming that imposition of the social security taxes violated his First Amendment Free Exercise rights and those of his Amish employees.[2]

The District Court held the statutes requiring appellee to pay social security and unemployment insurance taxes unconstitutional as applied. The court noted that the Amish believe it sinful not to provide for their own elderly and needy and therefore are religiously opposed to the national social security system.[3] The court also accepted appellee's contention that the Amish religion not only prohibits the acceptance of social security benefits, but also bars all contributions by Amish to the social security system. The District Court observed that in light of their beliefs, Congress has accommodated self-employed Amish and self-employed members of other religious groups with similar beliefs by providing exemptions from social security taxes. 26 U.S.C. §1402(g).[4] The court's holding was based on both the exemption statute for the self-employed and the First Amendment; appellee and others "who fall within the carefully circumscribed definition provided in 1402(g) are relieved from paying the employer's share of [social security taxes] as it is an unconstitutional infringement upon the free exercise of their religion."[5]

Direct appeal from the judgment of the District Court was taken pursuant to 28 U.S.C. §1252.

II

The exemption provided by §1402(g) is available only to self-employed individuals and does not apply to employers or employees. Consequently, appellee and his employees are not within the express provisions of §1402(g). Thus any exemption from payment of the employer's share of social security taxes must come from a constitutionally-required exemption.

A

The preliminary inquiry in determining the existence of a constitutionally-required exemption is whether the payment of social security taxes and the receipt of benefits interferes with the Free Exercise rights of the Amish. The Amish believe that there is a religiously based obligation to provide for their fellow members the kind of assistance contemplated by the social security system. Although the government does not challenge the sincerity of this belief, the government does contend that payment of social security taxes will not threaten the integrity of the Amish religious belief or observance. It is not within "the judicial function and judicial competence," however, to determine whether appellee or the government has the proper interpretation of the Amish faith; "[c]ourts are not arbiters of scriptural interpretation." *Thomas* v. *Review Bd. of Indiana Employment Sec.*, 101 S. Ct. 1425, 1431 (1981).[6] We therefore accept appellee's contention that both payment and receipt of social security benefits is forbidden by the Amish faith. Because the payment of the taxes or receipt of benefits violates Amish religious beliefs, compulsory participation in the social security system interferes with their Free Exercise rights.

---

[1] The Social Security Act and its subsequent amendments provide a system of old age and unemployment benefits. 26 U.S.C. §3101 *et seq*. These benefits are supported by various taxes, including, relevant to this appeal, the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA) tax. FICA is a tax paid in part by employees through withholding, 26 U.S.C. §3101, and in part by employers through an excise tax. 26 U.S.C. §3111. FUTA is an excise tax imposed only on employers. 26 U.S.C. §3301. Both taxes are based on the wages paid to employees, and the recordkeeping and transmittal of funds are obligations of the employer. Only FICA is collected from self-employed individuals.

In this case appellee failed to pay the employer's portion of FICA and FUTA taxes and failed to withhold his employee's contributions to FICA. An employer is liable for payment of the employee's share of FICA whether or not he withholds the required amount of the employee's contribution. 26 U.S.C. §3102(b).

[2] Appellee also requested injunctive relief to prevent the Commissioner of Internal Revenue from attempting to collect the unpaid balance of the assessments. Under the Internal Revenue Code, injunctive relief is to be granted sparingly and only in exceptional circumstances. 26 U.S.C. §742(a). The District Court therefore denied injunctive relief, but noted that should the government attempt to collect the remaining payments "further Court relief could be requested." District Court Op., Reprinted in Petition for Certiorari p. 8a.

[3] Appellee indicates that his scriptural basis for this belief was: "But if any provide not. . .for those of his own house, he hath denied the faith, and is worse than an infidel." (I Timothy 5:8)

[4] 26 U.S.C. §1402(g) provides, in part:

"(1) *Exemptions.* – Any individual may file an application. . .for an exemption from the tax imposed by this chapter if he is a member of a recognized religious sect or division thereof and is an adherent of established tenets or teachings of such sect or division by reason of which he is conscientiously opposed to acceptance of the benefits of any private or public insurance which makes payments in the event of death, disability, old-age, or retirement or makes payments toward the cost of, or provides services for, medical care (including the benefits of any insurance system established by the Social Security Act)."

In order to qualify for the exemption, the applicant must waive his right to all Social Security benefits and the Secretary of Health and Human Services must find that the particular religious group makes sufficient provision for its dependent members.

[5] The precise basis of the District Court opinion is not clear. The court recognized that on its face §1402(g) does not apply to appellee because he is not a self-employed individual. The District Court nonetheless used the language of §1402(g) to provide an exemption for appellee. The court's decision to grant appellee an exemption, however, appears to be based on its view that the statute was unconstitutional as applied. Consequently, this Court has jurisdiction under 28 U.S.C. §1252 to hear the appeal. *See also United States* v. *American Friends Service Committee*, 419 U.S. 7, 9 [Ct. D. 1968, 1975-1 C.B. 377] n. 4 (1974).

The conclusion that there is a conflict between the Amish faith and the obligations imposed by the social security system is only the beginning, however, and not the end of the inquiry. Not all burdens on religion are unconstitutional. *See, e.g., Prince* v. *Massachusetts*, 321 U.S. 158 (1944); *Reynolds* v. *United States*, 98 U.S. 145 (1879). The state may justify a limitation on religious liberty by showing that it is essential to accomplish an overriding governmental interest. *Thomas, supra; Wisconsin* v. *Yoder*, 406 U.S. 205 (1972); *Gillette* v. *United States*, 401 U.S. 437 (1971); *Sherbert* v. *Verner*, 374 U.S. 398 (1963).

B

Because the social security system is nationwide, the governmental interest is apparent. The social security system in the United States serves the public interest by providing a comprehensive insurance system with a variety of benefits available to all participants, with costs shared by employers and employees.[7] The social security system is by far the largest domestic governmental program in the United States today, distributing approximately $11 billion monthly to 36 million Americans.[8] The design of the system requires support by mandatory contributions from covered employers and employees. This mandatory participation is indispensable to the fiscal vitality of the social security system. "[W]idespread individual voluntary coverage under social security. . .would undermine the soundness of the social security program." S. Resp. No. 404, 89th Cong., 1st Sess., Pt. III, U.S. Code Cong. & Admin. News (1965), pp. 1943, 2056. Moreover, a comprehensive national social security system providing for voluntary participation would be almost a contradiction in terms and difficult, if not impossible, to administer. Thus, the government's interest in assuring mandatory and continuous participation in and contribution to the social security system is very high.[9]

C

The remaining inquiry is whether accommodating the Amish belief will unduly interfere with fulfillment of the governmental interest. In *Braunfeld* v. *Brown*, 366 U.S. 599, 605 (1961), this Court noted that "to make accommodation between the religious action and an exercise of state authority is a particularly delicate task. . .because resolution in favor of the State results in the choice to the individual of either abandoning his religious principles or facing. . .prosecution." The difficulty in attempting to accommodate religious beliefs in the area of taxation is that "we are a cosmopolitan nation made up of people of almost every conceivable religious preference." *Braunfeld*, 366 U.S. at 606. The Court has long recognized that balance must be struck between the values of the comprehensive social system, which rests on a complex of actuarial factors, and the consequences of allowing religiously based exemptions. To maintain an organized society that guarantees religious freedom to a great variety of faiths requires that some religious practices yield to the common good. Religious beliefs can be accommodated, *see, e.g., Thomas, supra; Sherbert, supra*, but there is a point at which accommodation would "radically restrict the operating latitude of the legislature." *Braunfeld, supra* at 606.[10]

Unlike the situation presented in *Wisconsin* v. *Yoder, supra*, it would be difficult to accommodate the comprehensive social security system with myriad exceptions flowing from a wide variety of religious beliefs. The obligation to pay the social security tax initially is not fundamentally different from the obligation to pay income taxes; the difference—in theory at least—is that the social security tax revenues are segregated for use only in furtherance of the statutory program. There is no principled way, however, for purposes of this case, to distinguish between general taxes and those imposed under the Social Security Act. If, for example, a religious adherent believes war is a sin, and if a certain percentage of the federal budget can be identified as devoted to war-related activities, such individuals would have a similarly valid claim to be exempt from paying that percentage of the income tax. The tax system could not function if denominations were allowed to challenge the tax system because tax payments were spent in a manner that violates their religious belief. *See, e.g., Lull* v. *Commissioner*, 602 F.2d 1166 (CA4 1979), *cert. denied*, 444 U.S. 1014 (1980); *Autenrieth* v. *Cullen*, 418 F.2d 586 (CA9 1969), *cert. denied*, 397 U.S. 103 1970). Because the broad public interest in maintaining a sound tax system is of such a high order, religious belie in conflict with the payment of taxe affords no basis for resisting the tax.

---

[6] This is not an instance in which the asserted claim is "so bizarre, so clearly nonreligious in motivation, as not to be entitled to protection under the Free Exercise Clause." *Thomas* v. *Review Bd. of Indiana Employment Sec.*, 101 S. Ct. 1425, 1431 (1981). At least one other religious organization has sought an exemption under §1402. *See also Henson* v. *Com'r of Internal Revenue*, 66 U.S.T.C. 835 (1976) (member of Sai Baba denied exemption because although opposed to insurance on religious grounds, the faith did not provide for its dependent members).

[7] The Social Security Act was enacted in 1935 to provide supplementary retirement benefits. Over the following 45 years coverage has broadened and the cost of the system has increased dramatically. See A. Abraham, et al., Federal Social Security (1979). In 1939 the Act was amended to provide insurance benefits for retired workers, auxiliaries of retired workers and survivors of deceased workers. In 1950 coverage was extended to self-employed workers and to select other employees previously excluded. In 1954 and 1956 disability benefits were added and in 1965 Medicare benefits were made available to participants in the System.

[8] National Commission on Social Security, Social Security in America's Future 5 (1981).

[9] The fiscal soundness of the Social Security System has been the subject of several studies and of congressional concern. *See, e.g.*, Congressional Budget Office, Paying for Social Security: Funding Options for the Near Future (1981).

[10] *See, e.g., Follett* v. *Town of McCormick* 321 U.S. 573 (1944) (preacher not entitled to b free from taxes); *Murdock* v. *Pennsylvania*, 31 U.S. 105, 112 (1943) (same).

III

Congress has accommodated, to the extent compatible with a comprehensive national program, the practices of those who believe it a violation of their faith to participate in the social security system. In §1402(g) Congress granted an exemption, on religious grounds, to self-employed Amish and others.[11] Confining the §1402(g) exemption to the self-employed provided for a narrow category which was readily identifiable. Self-employed persons in a religious community having its own "welfare" system are distinguishable from the generality of wage earners employed by others.

Congress and the courts have been sensitive to the needs flowing from the Free Exercise Clause, but every person cannot be shielded from all the burdens incident to exercising every aspect of the right to practice religious beliefs. When followers of a particular sect enter into commercial activity as a matter of choice, the limits they accept on their own conduct as a matter of conscience and faith are not to be superimposed on the statutory schemes which are binding on others in that activity. Granting an exemption from social security taxes to an employer operates to impose the employer's religious faith on the employees. Congress drew a line in §1402(g), exempting the self-employed Amish but not all persons working for an Amish employer. The tax imposed on employers to support the social security system must be uniformly applicable to all, except as Congress provides explicitly otherwise.[12]

Accordingly, the judgment of the District Court is reversed and the case remanded for proceedings consistent with this opinion.

---

26 CFR 31.3102-1: Collection of, and liability for, employee tax; in general.

Whether a corporation that treats its officers as independent contractors rather than as employees is entitled to relief under section 530 of the Revenue Act of 1978. See Rev. Rul. 82-83, this page.

---

26 CFR 31.3102-1: Collection of, and liability for, employee tax; in general.

Whether a taxpayer is entitled to relief under section 530 of the Revenue Act of 1978 for not treating alien agricultural workers as employees. See Rev. Rul. 82-116, page 152.

Subchapter B.—Tax on Employers

Section 3111.—Rate of Tax

26 CFR 31.3111-4: Liability for employer tax. (Also Sections 3102, 3301, 3403; 31.3102-1, 31.3301-1, 31.3403-1.)

Employer-employee; corporate officers. A corporation, whose officers perform functions within the scope of their duties as corporate officers and receive pay called "draws," is not entitled to relief under section 530 of the Revenue Act of 1978.

Rev. Rul. 82-83

ISSUE

Is a corporation that treats officers as independent contractors rather than as employees when they are performing duties normally within the scope of duties of a corporate officer entitled to relief under section 530 of the Revenue Act of 1978 (the Act), 1978-3 (Vol. 1) C.B. 1, 119, extended by section 9(d) of Pub. L. 96-167, 1980-1 C.B. 483, 486, and by section 1 of Pub. L. 96-541, 1980-2 C.B. 596?

FACTS

A corporation, which is owned by its two officers (president and vice-president/treasurer, respectively) operates a summer theater. The officers perform substantial services for the corporation, including deciding on productions to be performed, setting admission prices, and hiring performers. The officers control and direct all of the operations of the theater and determine the amount of their own compensation, the hours of their employment, and the duties they will perform.

The corporation treats the officers as independent contractors rather than employees and pays them compensation characterized as "draws" rather than "salaries." In treating the officers as independent contractors, the corporation does not rely on any basis that would fall within the "safe haven" provisions of section 530 (a)(2)(A), (B), or (C) of the Act.

LAW AND ANALYSIS

Section 530 of the Act provides relief from employment tax liability to eligible taxpayers who have failed to pay or withhold employment taxes on remuneration paid to workers because the taxpayers did not regard them as employees. Section 530(a)(1), as extended, provides, in general, that if a taxpayer did not treat an individual as an employee for any period ending before July 1, 1982, the individual will be deemed not to be an employee for purposes of applying employment taxes for the period unless the taxpayer had no reasonable basis for treating the individual as other than an employee.

Section 530(a)(2) provides several alternative standards that constitute "safe havens" in determining whether a taxpayer has a "reasonable basis" for not treating an individual as an employee. Reasonable reliance on any one of the following "safe havens" is sufficient:

(A) Judicial precedent or published rulings (whether or not relating to the particular industry or business in which the taxpayer is engaged), technical advice, a letter ruling, or a determination letter pertaining to the taxpayer.

(B) A past Internal Revenue Service audit (not necessarily for employment tax purposes) of the taxpayer, if the audit entailed no assessment attributable to the taxpayer's employment tax treatment of individuals holding positions substantially similar to that held by the individual whose status is at issue. However, a taxpayer does not meet this test if, in the conduct of a prior audit, an assessment attributable to the taxpayer's treatment of the individual was offset by other claims asserted by the taxpayer.

---

[11] The District Court read this as extending to the present claims. We need not decide whether the Free Exercise Clause compelled an exemption as provided by §1402(g); Congress' grant of the exemption was an effort toward accommodation. Nor do we need to decide whether, if Congress had, as the District Court believe, intended §1402(g) to reach this case, conflicts with the Establishment Clause would arise.

[12] We note that here the statute compels contributions to the system by way of taxes; it does not compel anyone to accept benefits. Indeed, it would be possible for an Amish member, upon qualifying for social security benefits, to receive and pass them along to an Amish fund having parallel objectives. It is not for us to speculate whether this would ease or mitigate the perceived sin of participation.

(C) Long-standing recognized practice of a significant segment of the industry in which the individual was engaged. It is not necessary that the practice be uniform throughout an entire industry.

Taxpayers who fail to meet any of these three "safe havens" may nevertheless be entitled to relief if they can demonstrate, in some other manner, a reasonable basis for not treating the individual as an employee. The term "reasonable basis" should be construed liberally in favor of the taxpayer.

Sections 3121(d) and 3401(c) of the Internal Revenue Code, applicable to the Federal Insurance Contributions Act and income tax withholding, respectively, provide that the term "employee" includes any officer of a corporation. Section 3306(i), applicable to the Federal Unemployment Tax Act, includes within the meaning of the term "employee" the meaning assigned by section 3121(d).

Section 31.3121(d)-1(b) of the Employment Tax Regulations states that, generally, an officer of a corporation is an employee of the corporation. However, an officer of a corporation who as such does not perform any services or performs only minor services and who neither receives nor is entitled to receive, directly or indirectly, any pay is considered not to be an employee of the corporation. For instance, directors of corporations in their capacity as such are not employees of the corporations.

Rev. Rul. 71-86, 1971-1 C.B. 285, holds that when an individual who is the president and sole shareholder, except for qualifying shares, of a closely held corporation performs services as an officer of the corporation, the president is an employee for purposes of employment taxes and income tax withholding, even though all services performed and the amount of compensation for them are under the individual's complete control.

Rev. Rul. 73-361, 1973-2 C.B. 331, holds that a stockholder-officer of an electing small business corporation who performs substantial services as an officer of the corporation is its employee for purposes of the FICA, the FUTA, and income tax withholding.

In *Royal Theatre Corp. v. United States*, 66 F. Supp. 301 (D. Kan. 1946), the sole shareholder and president of two corporations contracted with each for him to manage each corporation's operations and to determine matters of policy for each corporation. The court observed that compensation an officer receives for services as an officer is subject to social security taxes, and held that the contracts by which the president of each corporation purportedly managed the affairs of each corporation as an independent contractor could be disregarded in determining the reality of the situation.

It is a question of fact in all cases whether officers of a corporation are performing services within the scope of their duties as officers or whether they are performing services as independent contractors. Here, the duties being performed customarily fall within the scope of duties of corporate officers. Involved are fundamental decisions regarding the operation of the corporation. Such decisions are rarely delegated to independent contractors, and are customarily made by corporate officers or other employees. Thus, since the officers are performing substantial services typical of officers and are paid for those services, they are employees of the corporation for purposes of federal tax law. Therefore, even though the corporation calls the officers' pay "draws" rather than "salaries," there is no reasonable basis for treating the officers as other than employees, even under a liberal application of the reasonable basis rule of section 530 of the Act.

HOLDING

The corporation is not entitled to relief under section 530 of the Act.

---

26 CFR 31.3111-4: Liability for employer tax. (Also Sections 3102, 3301, 3403; 31.3102-1, 31.3301-1, 31.3403-1.)

Employee; illegal aliens. A taxpayer who has both U.S. citizens and illegal aliens performing the same services for the taxpayer but does not withhold federal employment taxes from the remuneration of the alien workers is not entitled to relief under section 530 of the Revenue Act of 1978.

Rev. Rul. 82-116

ISSUE

Is a taxpayer who employs aliens to perform agricultural labor under the facts below, entitled to relief under section 530 of the Revenue Act of 1978 (the Act), Pub.L. 95-600, 1978-3 (Vol. 1) C.B. 1, 119, extended by section 9(d) of Pub. L. 96-167, 1980-1 C.B. 483, 486, and by section 1 of Pub. L. 96-541, 1980-2 C.B. 596?

FACTS

In 1977, a taxpayer hired a group of workers to perform services on the taxpayer's farm. The group consisted of aliens who entered the United States illegally. The taxpayer did not pay or withhold Federal Insurance Contributions Act (FICA) taxes with respect to remuneration paid to the alien workers because they did not have social security numbers and were present in the United States illegally. The taxpayer did file Form 943, Employers Annual Tax Return for Agricultural Employees, and pay and withhold FICA taxes with respect to remuneration paid to U.S. citizens who perform the same type of work.

LAW AND ANALYSIS

Section 530 of the Act provides relief from employment tax liability to eligible taxpayers who failed to pay or withhold employment taxes on remuneration paid to workers because the taxpayers did not regard them as employees. Section 530(a)(1), as extended, provides, in general, that if a taxpayer did not treat an individual as an employee for any period ending before July 1, 1982, the individual will be deemed not to be an employee for purposes of applying employment taxes for the period unless the taxpayer had no reasonable basis for treating the individual as other than an employee.

Section 530(a)(2) of the Act provides several alternative standards that constitute "safe havens" in determining whether a taxpayer has a "reasonable basis" for not treating an individual as an employee. Reasonable reliance on any one of the following "safe havens" is sufficient:

(A) judicial precedent or published rulings, whether or not relating to the particular industry or business in which the taxpayer is engaged, or on technical advice, a letter ruling, or a determination letter pertaining to the taxpayer; or

(B) a past Internal Revenue Service audit (not necessarily for employment tax purposes) of the taxpayer, if the audit entailed no assessment attributable to the taxpayer's employment tax treatment of individuals holding positions substantially similar to the position held by the individual whose status is at issue; however, a taxpayer does not meet this test if, in the conduct of a prior audit, an assessment attributable to the taxpayer's treatment of the individual was offset by other claims asserted by the taxpayer; or

(C) long-standing recognized practice of a significant segment of the industry in which the individual was engaged. It is not necessary that the practice be uniform throughout an entire industry.

A taxpayer who fails to meet any of the three "safe havens" is nevertheless entitled to relief if the taxpayer can demonstrate, in some other manner, a reasonable basis for not treating the individual as an employee. The term "reasonable basis" should be construed liberally in favor of the taxpayer.

The intent of Congress in enacting section 530 of the Act was to provide interim employment tax relief for taxpayers involved in controversies with the Internal Revenue Service over whether individuals treated as independent contractors should be reclassified as employees. See, H.R. Rep. No. 95-1748, 95th Cong., 2d Sess. 1, (1978), 1978-3 (Vol. 1) C.B. 629.

Rev. Rul. 77-140, 1977-1 C.B. 301, holds that services performed for farmers in the United States by alien workers who illegally entered the country are not excepted from employment for purposes of the Federal Insurance Contributions Act.

In the present case the taxpayer's failure to withhold or pay FICA taxes on the alien workers was not based upon a belief by the taxpayer that they were independent contractors rather than employees. The sole reason for not withholding was that the alien workers were present in the United States illegally and had no social security numbers. Accordingly, the provisions of section 530 of the Act do not apply to this case.

HOLDING

The taxpayer is not entitled to relief under section 530 of the Act.

Subchapter C.—General Provisions

Section 3121.—Definitions

26 CFR 31.3121(a)(2)-1: Payments under employers' plans on account of retirement, sickness or accident disability, medical or hospitalization expenses, or death.

Questions and answers regarding the taxability of sick pay under the Federal Insurance Contributions Act and the Railroad Retirement Tax Act as amended by Pub. L. 97-123. See Rev. Proc. 82-20, page 466.

Chapter 22.—Railroad Retirement Tax Act
Subchapter C.—Tax on Employers

Section 3221.—Rate of Tax

Railroad Retirement Board

Determination of Quarterly Rate of Excise Tax for Railroad Retirement Supplemental Annuity Program

In accordance with directions in section 3221(c) of the Railroad Retirement Tax Act (26 U.S.C. 3221(c)), the Railroad Retirement Board has determined that the excise tax imposed by such section 3221(c) on every employer, with respect to having individuals in his employ, for each work-hour for which compensation is paid by such employer for services rendered to him during the quarter beginning April 1, 1982, shall be at the rate of 17 cents.

In accordance with directions in section 15(a) of the Railroad Retirement Act of 1974, the Railroad Retirement Board has determined that for the quarter beginning April 1, 1982, 20.8 percent of the taxes collected under sections 3211(b) and 3221(c) of the Railroad Retirement Tax Act shall be credited to the Railroad Retirement Account and 79.2 percent of the taxes collected under such sections 3211(b) and 3221(c) plus one hundred percent of the taxes collected under section 3221(d) of the Railroad Retirement Tax Act shall be credited to the Railroad Retirement Supplemental Account.

Dated: February 8, 1982.

By Authority of the Board:

JAMES T. BROWN,
Chief Executive Officer.

(Filed by the Office of the Federal Register on February 18, 1982, 8:45 a.m., and published in the issue of the Federal Register for February 19, 1982, 47 F.R. 7566)

Railroad Retirement Board

Determination of Quarterly Rate of Excise Tax for Railroad Retirement Supplemental Annuity Program

In accordance with directions in section 3221(c) of the Railroad Retirement Tax Act (26 U.S.C. 3221(c)), the Railroad Retirement Board has determined that the excise tax imposed by such section 3221(c) on every employer, with respect to having individuals in his employ, for each work-hour for which compensation is paid by such employer for services rendered to him during the quarter beginning July 1, 1982, shall be at the rate of seventeen cents.

In accordance with directions in section 15(a) of the Railroad Retirement Act of 1974, the Railroad Retirement Board has determined that for the quarter beginning July 1, 1982, 21.2 percent of the taxes collected under sections 3211(b) and 3221(c) of the

Railroad Retirement Tax Act shall be credited to the Railroad Retirement Account and 78.8 percent of the taxes collected under such sections 3211(b) and 3221(c) plus one hundred percent of the taxes collected under section 3221(d) of the Railroad Retirement Tax Act shall be credited to the Railroad Retirement Supplemental Account.

Dated: May 7, 1982.

By authority of the Board.

JAMES T. BROWN,
Chief Executive Officer.

(Filed by the Office of the Federal Register on May 12, 1982, 8:45 a.m., and published in the issue of the Federal Register for May 13, 1982, 47 F.R. 20706)

Subchapter D.—General Provisions

Section 3231.—Definitions

26 CFR 31.3231(a)-1: Who are employers.

RRTA; employer; company operating docking facility for carrier. A company that operates a docking facility under contract with a railroad carrier, but is not directly or indirectly owned or controlled by the carrier, is not an employer under section 3231(a) of the Code.

Rev. Rul. 82-64

ISSUE

Is a company providing railroad-related services as described below indirectly controlled by a carrier and therefore an employer under section 3231(a) of the Internal Revenue Code?

FACTS

A railroad that is a carrier as defined in section 3231(g) of the Code owns a docking facility and has a contract with company *X* to operate the facility. Under the contract *X* is prohibited from performing services for others and has no other income. Either the railroad or *X* can terminate the contract upon six months notice. *X* unloads ore from ships moored at the dock and transfers the ore into railroad cars for shipment by rail. The railroad pays *X* a fixed fee for each ton of ore transferred and the fee is renegotiated from time to time. While all the equipment at the facility is owned by the railroad, all the workers at the facility are employees of *X*. None of the directors or officers of *X* are associated in any way with the railroad. The railroad does not own either directly or indirectly any of the stock of *X*.

LAW AND ANALYSIS

Section 3231(a) of the Code defines, for purposes of the Railroad Retirement Tax Act, Pub. L. 572, 1946-2 C.B. 269, the term "employer" as any carrier within the meaning of section 3231(g) and any company which is directly or indirectly owned or controlled by a carrier and which performs any service, except trucking or casual service, in connection with the transportation of property by railroad.

Section 3231(g) of the Code defines the term "carrier" as an express carrier, sleeping car carrier, or rail carrier providing transportation subject to subchapter I of chapter 105 of title 49.

Section 31.3231(a)-1(b) of the Employment Tax Regulations provides that the term "controlled" includes direct or indirect control, whether legally enforceable or not and however exercisable or exercised. The control may be by means of stock ownership or by agreements, licenses, or any other devices that insure that the operation of the company is in the interest of one or more carriers. It is the reality of the control that is decisive, however, not its form nor the mode of its exercise.

In Rev. Rul. 77-386, 1977-2 C.B. 356, a company wholly owned by a carrier railroad operated pier facilities for the loading and unloading of ships, trucks, and railcars and was held to be performing a service in connection with the transportation of property by railroad. The company therefore was held to be an employer under section 3231(a) of the Code.

In *Martin v. Federal Security Agency*, 174 F.2d 364 (3rd Cir. 1949) and *Pennsylvania Railroad Company v. United States*, 70 F. Supp. 595 (Ct. Cl. 1947), docking facilities owned by carriers were leased to companies that operated the facilities. In each case the company was held not to be indirectly controlled by the carrier.

In *Martin*, the court determined that whether any company is directly or indirectly owned or controlled by a carrier depends on the controls of a company attained through financial arrangements, stock ownership, voting trusts, interlocking directorates, and other corporate and business devices that have regard to its management, business policies, or corporate functions. The court also stated that the phrase "company which is directly or indirectly owned or controlled by one or more of such carriers" means a present, legal power of control and does not mean "any company which *could be controlled* by threats of cancellation, or by cancellation, of its contract by the carrier."

HOLDING

Company *X* is not an employer for purposes of section 3231(a) of the Code because it is neither directly or indirectly owned nor controlled by a carrier.

---

26 CFR 31.3231(a)-1: Who are employers.

Employer; cessation of tax liability. A railroad ceases to be an employer subject to the RRTA taxes when the railroad's employees stop performing services in connection with the railroad's carrier activities and not on the effective date of the ICC's approval of the railroad's abandonment of its operations.

Rev. Rul. 82-99

ISSUE

When does a company cease to be an employer under section 3231(a) of the Internal Revenue Code and no longer subject to the taxes under section 3221?

FACTS

A company subject to the taxes under section 3221 of the Code petitioned the Interstate Commerce Commission (ICC) for approval to abandon its lines and to cease operations. The ICC approved the company's petition effective June 1, 1980, and the company ceased carrier operations on that date. Between June 1, 1980 and August 1, 1981, the company maintained a small office staff to pay remaining bills, receive payments and to sell the rolling stock. On August 1, 1981, the company's offices were closed, all assets having been disposed of except for some real estate holdings unrelated to rail transportation.

LAW AND ANALYSIS

Section 3221 of the Code imposes a tax on every employer as defined in section 3231(a).

Section 3231(a) of the Code provides, in part, that the term "employer" means any carrier as defined in section 3231(g).

Section 3231(g) of the Code provides that the term "carrier" means an express carrier, sleeping car carrier, or rail carrier providing transportation subject to subchapter I of chapter 105 of title 49.

Although the ICC approved the company's abandonment of its lines effective June 1, 1980, and the company is no longer subject to the ICC's regulation, the company's employees continued to perform services that were in connection with carrier activities until August 1, 1981.

HOLDING

The company ceased to be an employer subject to the taxes under section 3221 of the Code on August 1, 1981.

---

26 CFR 31.3231(a)-1: Who are employers.

Employer; beginning of tax liability. A company becomes an employer subject to the RRTA taxes on the date the company first hires employees to perform functions directly related to its carrier operations and not on the effective date of the ICC's approval of the company's railroad operations.

Rev. Rul. 82-100

ISSUE

When does a company become an employer under section 3231(a) of the Internal Revenue Code and subject to the taxes under section 3221?

FACTS

On February 1, 1981, a company hired employees to perform functions directly related to its commencement of railroad carrier operations. The Interstate Commerce Commission approved the operation of the railroad effective March 1, 1981, and issued a certificate of convenience and necessity to operate the railroad between two cities.

LAW AND ANALYSIS

Section 3221 of the Code imposes a tax on every employer as defined in section 3231(a).

Section 3231(a) of the Code provides, in part, that the term "employer" means any carrier as defined in section 3231(g).

Section 3231(g) of the Code provides that the term "carrier" means an express carrier, sleeping car carrier, or rail carrier providing transportation subject to subchapter I of chapter 105 of title 49.

HOLDING

The company became an employer subject to the taxes under section 3221 of the Code on February 1, 1981, the date it hired employees to perform functions directly related to its carrier operations.

---

26 CFR 31.3231(e)-1: Compensation.

Questions and answers regarding the taxability of sick pay under the Federal Insurance Contributions Act and the Railroad Retirement Tax Act as amended by Pub. L. 97-123. See Rev. Proc. 82-20, page 466.

Chapter 23.—Federal Unemployment Tax Act

Section 3301.—Rate of Tax

26 CFR 31.3301-1: Persons liable for tax.

Whether a corporation that treats its officers as independent contractors rather than as employees is entitled to relief under section 530 of the Revenue Act of 1978. See Rev. Rul. 82-83, page 151.

---

26 CFR 31.3301-1: Persons liable for tax.

Whether a taxpayer is entitled to relief under section 530 of the Revenue Act of 1978 for not treating alien agricultural workers as employees. See Rev. Rul. 82-116, page 152.

Section 3302.—Credits Against Tax

26 CFR 31.3302(a)-1: Credit against tax for contributions paid.

Whether employers in New Hampshire are entitled to the credit for 1978. See Rev. Proc. 82-34, page 489.

---

26 CFR 31.3302(c)-1: Limit on total credits.

Reductions in credit applicable to employers for whom services are performed in various "states." See Rev. Proc. 82-1, page 366.

Section 3303.—Conditions of Additional Credit Allowance

The Secretary of Labor's certification of the New Hampshire Law for 1978. See Rev. Proc. 82-34, page 489.

Section 3304.—Approval of State Laws

The Secretary of Labor's certification of the New Hampshire law for 1978. See Rev. Proc. 82-34, page 489.

Section 3310.—Judicial Review

Effect of settlement of judicial proceedings regarding the Secretary of Labor's certification of the New Hampshire law for 1978. See Rev. Proc. 82-34, page 489.

Chapter 24.—Collection of Income Tax at Source on Wages

Section 3401.—Definitions

26 CFR 31.3401(d)-1: Employer.

Whether payments made under eligible state deferred compensation plans are subject to income tax withholding, and under what circumstances are they to be treated as supplemental wage payments in computing the amounts to be withheld. See Rev. Rul. 82-46, page 158.

Section 3402.—Income Tax Collected at Source

26 CFR 31.3402(f)(2)-1: Withholding exemption certificates.

T.D. 7803

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 31—EMPLOYMENT TAXES; APPLICABLE ON OR AFTER JANUARY 1, 1955; PART

37—TEMPORARY EMPLOYMENT TAX REGULATIONS FOR WITHHOLDING EXEMPTION CERTIFICATES

Submission of certain withholding certificates

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final Employment Tax Regulations (26 CFR Part 31) relating to the submission of certain withholding exemption certificates (Forms W-4). The regulations provide guidance to employers and employees with respect to the furnishing and honoring of employee withholding exemption certificates.

DATE: This document is effective with respect to withholding exemption certificates furnished by employees to employers on or after February 25, 1982.

FOR FURTHER INFORMATION CONTACT: Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) [LR-50-81] (202-566-3829).

SUPPLEMENTARY INFORMATION

BACKGROUND

On March 19, 1981, the FEDERAL REGISTER published proposed amendments to the Employment Tax Regulations (26 CFR Part 31) under sections 3401 and 3402 of the Internal Revenue Code of 1954 (46 FR 17566) [LR-50-81, 1981-1 C.B. 765]. On the same date, the FEDERAL REGISTER also published Temporary Employment Tax Regulations for Withholding Exemption Certificates (26 CFR Part 37) under section 3402 of the Internal Revenue Code of 1954 (46 FR 17547) [T.D. 7772, 1981-1 C.B. 488]. A public hearing was held on June 2, 1981. After consideration of all comments regarding the proposed amendments, those amendments are adopted as revised by this Treasury decision.

ISSUES

Comments received from employers dealt with several issues. Some employers were concerned that §37.3402-1(e)(4) of the temporary regulations, relating to the requirement that an employer submit to the Service any new Form W-4 and supporting statement that makes a claim inconsistent with the Service's prior notice to the employer, unnecessarily interposed the employer in the middle of a dispute between the employee and the Service. These employers suggested that the regulations be changed to require the employee to submit this form and statement directly to the Service. The final regulations have been modified to permit the employee to submit a new Form W-4 (with supporting statement) that makes a claim inconsistent with the notice furnished by the Service to the employer either (1) directly to the Service or (2) to the employer who must then forward it to the Service.

Several employers were concerned about the length of time the Service may take to review some W-4 certificates. The Service has developed new internal administrative measures to provide for monthly processing in order to reduce the period of any employer or employee uncertainty over the validity of the employee's claims.

Several employers expressed concern about recordkeeping burdens imposed on them by the regulations. Because the Code assigns to the employer the responsibility for collecting income taxes at the source on wages, it is impossible to eliminate this burden. Several other employers expressed appreciation for the provisions that based the employer's responsibility to submit Forms W-4 upon an objective numerical standard, rather than upon a subjective, case-by-case standard. The final regulations have been modified to require that employers submit to the Service copies of Forms W-4 that claim more than 14 exemptions, rather than more than 9 exemptions. This change will decrease the paperwork burden on employers. The submission requirements for Forms W-4 that claim exempt status are unchanged.

Comments received from certain individuals expressed the view that income tax withholding from wages constitutes a violation of one or more provisions of the United States Constitution. For example, the provisions forbidding unlawful seizures and deprivations of property under the Fourth and Fifth Amendments to the United States Constitution were cited.

The Federal withholding system does not violate any rights of taxpayers under the Constitution. The Supreme Court has denied a constitutional challenge to the withholding system in a case where the taxpayers sought to enjoin withholding from their wages. *United States v. American Friends Service Committees, et al.*, 419 U.S. 7 (1974) [Ct. D. 1968, 1975-1 C.B. 377]. Also, the United States Court of Appeals for the Tenth Circuit has specifically held that federal income tax withholding does not result in the taking of property without due process. *Campbell v. Amax Coal Co.*, 610 F.2d 701 (10 Cir. 1979). This holding was based on an earlier decision in which the Supreme Court refused to grant the petitioner a writ of certiorari. *United States v. Smith*, 484 F.2d 8 (10th Cir. 1973); cert. denied, 415 U.S. 978.

DRAFTING INFORMATION

The principal author of these final regulations is Charles C. Saverude of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, the following amendments are made to the Employment Tax Regulations (26 CFR Part 31), and the Temporary Employment Tax Regulations for Withholding Exemption Certificates (26 CFR Part 37) are deleted from the Code of Federal Regulations.

Part 31—Employment Taxes; Applicable on or after January 1, 1955

Paragraph 1. The last sentence of paragraph (b) of §31.3401(e)-1 is amended by removing "§37.3402-1" and inserting in lieu thereof "§31.3402(f)(2)-1(g)".

Par. 2. The last sentence preceding Example (1) of §31.3402(n)-1 is amended by removing "§37.3402-1" and inserting in lieu thereof "§31.3402(f)(2)-1(g)".

Par. 3. Section 31.3402(f)(2)-1 is amended by the addition of a new paragraph (g) thereto to read as follows:

§31.3402(f)(2)-1 Withholding exemption certificates.

* * * * *

(g) *Submission of certain withholding certificates*—(1) *General rule.* An employer shall submit, in accordance with paragraph (g)(3) of this section, a copy of any withholding exemption certificate, together with a copy of any written statement received from the employee in support of the claims made on the certificate, which is received from the employee during the reporting period (even if not in effect at the end of the quarter) if the employee is employed by that employer on the last day of the reporting period and if—

(i) The total number of withholding exemptions (within the meaning of section 3402(f)(1) and the regulations thereunder) claimed on the certificate exceeds 14, or

(ii) The certificate indicates that the employee claims a status exempting the employee from withholding, and the exception provided by paragraph (g)(2) of this section does not apply.

(2) *Exception.* A copy of the certificate shall not be submitted under paragraph (g)(1)(ii) of this section if the employer reasonably expects, at the time the certificate is received, that the employee's wages (under chapter 24 of the Code) from that employer shall not then usually exceed $200 per week.

(3) *Rules for submission*—(i) *In general.* The reporting period is a calendar quarter. Copies required to be submitted under paragraph (g)(1) of this section shall be submitted at the time and place of filing Form 941 or 941E for the reporting period, or Form 941-M for the last month of the reporting period. Form 941, 941E or 941-M shall be used, in accordance with the instructions for the form, to transmit the copies.

(ii) *Option.* At the choice of the employer, copies required to be submitted under paragraph (g)(1) of this section may be submitted earlier and for shorter reporting periods than a calendar quarter. In such case, the employer shall submit the copies to the service center where the employer would file a Form 941 or 941E and shall include with the submission a statement showing the employer's name, address, employer identification number, and the number of copies of withholding exemption certificates submitted. However, in no event shall a copy be submitted later than the time for filing the report required to be submitted for the calendar quarter reporting period under subdivision (1) of this paragraph (g)(3).

(iii) *First report.* The first submission of copies shall include a copy of any certificate required to be submitted under paragraph (g)(1) of this section which is received by the employer on or after April 1, 1980.

(4) *Other withholding exemption certificates.* An employer shall also submit a copy of any currently effective withholding exemption certificate (or make the original certificate available for inspection), together with a copy of any written statement received from the employee in support of the claims made on the certificate, upon written request of the Internal Revenue Service. This request of the Service may relate either to one or more named employees or to one or more reasonably segregable units of the employer. In this regard, the Service may, by written notice, advise the employer that a copy of each new withholding exemption certificate received from one or more named employees, or from one or more reasonably segregable units of the employer, which is required, under this paragraph (g) to be submitted to the Service is to be submitted to the District Director. The employer shall then submit to the District Director a copy of each such new certificate of each such employee immediately after the employer receives the new certificate from the named employee.

(5) *Computation of withholding.* (1) Until receipt of written notice from the Internal Revenue Service that a certificate, a copy of which was submitted under this section, is defective, that certificate is effective and the employer shall withhold on the basis of the statements made in that certificate, unless that certificate must be disregarded under the provisions of subdivision (vi) of this paragraph (g)(5).

(ii) The Internal Revenue Service may find that a copy of a withholding exemption certificate submitted contains a materially incorrect statement or it may determine, after written request to the employee for verification of the statements on the certificate, that it lacks sufficient information to determine if the certificate is correct. If the Internal Revenue Service so finds or determines and notifies the employer in writing that the certificate is defective, the employer shall then consider the certificate to be defective for purposes of computing amounts of withholding.

(iii) If the Internal Revenue Service notifies the employer that the certificate is defective, the Internal Revenue Service will, based upon its findings, advise the employer that the employee either is not entitled to claim a status exempting the employee from withholding or is not entitled to claim a total number of withholding exemptions in excess of a number specified by the Internal Revenue Service in the notice, or both. The Internal Revenue Service will also specify the Internal Revenue Service office to be contacted for further information.

(iv) The Internal Revenue Service will provide the employer with a copy for the employee of each notice it furnishes to the employer under this paragraph (g)(5) in addition to the notice furnished to the employer for his own use. The Internal Revenue Service will also mail a similar notice to the employee at the address of the employee as shown on the certificate under review.

(v) The employer shall promptly furnish the employee who filed the defective certificate, if still in his employ, with a copy of the written notice of the Internal Revenue Service with respect to the certificate and may request another withholding exemption certificate from the employee. The employer shall withhold amounts from the employee on the basis of the maximum number specified in the written notice received from the Service.

(vi) If and when the employee does file any new certificate (after an earlier certificate of the employee was considered to be defective), the employer shall withhold on the basis of that new certificate (whenever filed) as currently effective only if the new certificate does not make a claim of exempt status or of a number of withholding exemptions which claim is inconsistent with the advice earlier furnished by the Internal Revenue Service in its written notice to the employer. If any new certificate does make a claim which is inconsistent with the advice contained in the Service's written notice to the employer, then the employer shall disregard the new certificate, shall not submit that new certificate to the Service, and shall continue to withhold amounts from the employee on the basis of the maximum number specified in the written notice received from the Service.

(vii) If the employee makes a claim on any new certificate that is inconsistent with the advice in the Service's written notice to the employer, the employee may specify on such new certificate, or by a written statement attached to that certificate, any circumstances of the employee which have changed since the date of the Service's earlier written notice, or any other circumstances or reasons, as justification or support for the claims made by the employee on the new certificate. The employee may then submit that new certificate and written statement either to (A) the Internal Revenue Service office specified in the notice earlier furnished to the employer under this paragraph (g)(5), or to (B) the employer, who must then submit a copy of that new certificate and the employee's written statement (if any) to the Internal Revenue Service office specified in the notice earlier furnished to the employer. The employer shall continue to disregard that new certificate and shall continue to withhold amounts from the employee on the basis of the maximum number specified in the written notice received from the Service unless and until the Internal Revenue Service by written notice (under subdivision (iii) of this paragraph (g)(5)) advises the employer to withhold on the basis of that new certificate and revokes its earlier written notice.

(6) *Definition of employer.* For purposes of this paragraph (g), the term "employer" includes any individual authorized by the employer to receive withholding exemption certificates, to make withholding computations, or to make payroll distributions.

Part 37—Temporary Employment Tax Regulations for Withholding Exemption Certificates [Removed]

Par. 4. The Temporary Employment Tax Regulations for Withholding Exemption Certificates, 26 CFR Part 37, are hereby removed.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

ROSCOE L. EGGER, JR.,
Commissioner of
Internal Revenue.

Approved January 18, 1982.

JOHN E. CHAPOTON,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on January 21, 1982, 4:22 p.m., and published in the issue of the Federal Register for January 26, 1982, 47 F.R. 3546)

---

26 CFR 31.3402(f)(2)-1: Withholding exemption certificates.

Whether an employer may repay or reimburse an employee for income taxes collected during the year when the employee furnishes a new withholding exemption certificate to the employer. See Rev. Rul. 82-84, page 208.

---

26 CFR 31.3402(g)-1: Supplemental wage payments.
(Also Section 3401; 31.3401(d)-1.)

Withholding; supplemental wage payments. Payments made under an eligible state deferred compensation plan are subject to income tax withholding and under certain circumstances are to be treated as supplemental wage payments.

Rev. Rul. 82-46

ISSUE

Are payments made under eligible state deferred compensation plans subject to income tax withholding, and under what circumstances are they to be treated as supplemental wage payments in computing the amounts to be withheld?

FACTS

City *X* and City *Y* both maintain eligible state deferred compensation plans as defined in section 457 of the Internal Revenue Code. Under the plans, eligible employees who choose to participate agree to the deferral of part of their compensation. *X* and *Y* withhold the agreed amounts from current wages and credit them to the accounts of the individual employees. The accumulated amounts plus income earned are paid over upon termination of employment. Participating employees are also covered by the regular retirement plans maintained by *X* and *Y*. These retirement plans are not qualified pension plans under section 401 of the Code. *X*'s regular retirement plan is administered by an insurance company, which has control of the payment of benefits. *Y* maintains and administers its own retirement plan.

LAW AND ANALYSIS

Section 3402(a) imposes on employers the duty to deduct and withhold income tax upon wages paid.

Section 3401(a) of the Code defines wages as all remuneration for services performed by an employee for an employer. There are no exceptions from income tax withholding under section 3401 for payments from deferred compensation plans as defined in section 457.

Section 3401(d)(1) of the Code provides that if the person for whom the individual performs services does not have control of the payment of the wages for such services, the term "employer" means the person having control of the payment of such wages.

Section 31.3402(g)-1 of the Employment Tax Regulations deals with income tax withholding on supplemental wages, such as bonuses, commissions, and overtime pay, which may be paid for either the same or a different period as the payroll period for regular wages, or may be paid without regard to a particular period. The amount of income tax to be withheld by the employer on such supplemental wages depends, in part, on whether or not income tax has been withheld from the employee's regular wages.

When an employer pays an employee wages in addition to regular wages and includes both amounts in a single payment, the amount of income tax to be withheld is determined on the basis of the aggregate amount, under the standard wage bracket or percentage method. See Rev. Rul. 67-88, 1967-1 C.B. 289.

Section 31.3402(g)-1 of the regulations provides that an employer who separately pays both regular wages and supplemental wages to an employee and withholds income tax on the regular wages may either (1) withhold tax on the supplemental wages at the flat percentage rate of 20 percent without allowance for any withholding exemptions the employee claimed on Form W-4, or (2) aggregate the supplemental wage payment with the regular wages paid or to be paid the employee in the same calendar year either for the last preceding payroll period or for the current payroll period, determine the income tax to be withheld as if the aggregate amount were a single payment, subtract from the amount of income tax so determined the income tax already withheld or to be withheld from the regular wage payment, and withhold the remaining tax from the supplemental wage payment.

Rev. Rul. 66-294, 1966-2 C.B. 459, provides that if the employer makes a supplemental wage payment to an employee and has not withheld on the employee's regular wages (as, for example, where an employee's withholding exemptions exceeded the employee's wages), then the employer must use the second method, so that the employee will receive the benefit of the withholding exemptions to which the employee is entitled. Thus, the employer must aggregate the supplemental wage payment with the regular wages paid or to be paid in the same calendar year either for the last preceding payroll period or for the current payroll period and withhold income tax thereon at the regular graduated rates as if the aggregate of the supplemental wages and the regular wages were a single payment for the regular payroll period.

HOLDING

Payments from the eligible state deferred compensation plans are wages subject to withholding, and payments are reportable on Form W-2, Wage and Tax Statement.

In the case of *X*, since the insurance company has control of payments under the retirement plan, it and not *X* is the "employer" for purposes of income tax withholding with regard to those wages. *X* is the "employer" as to payments from its eligible state deferred compensation plan. Therefore, *X* should not treat the payments from the deferred compensation plan as supplemental wage payments. They are payments of regular wages.

Because *Y* makes payments under both the retirement plan and the deferred compensation plan *Y* should treat the amounts paid employees under the deferred compensation plan as supplemental wage payments.

---

26 CFR 31.3402(o)-2: Extension of withholding to annuity payments if requested by payee.

T.D. 7804

TITLE 26.—INTERNAL REVENUE.—CHAPTER 1, SUBCHAPTER C, PART 31,—EMPLOYMENT TAXES; APPLICABLE ON OR AFTER JANUARY 1, 1955; PART 32.—TEMPORARY EMPLOYMENT TAX REGULATIONS UNDER THE TAX REFORM ACT OF 1969

Voluntary withholding from annuity payments

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final Employment Tax Regulations (26 CFR Part 31) relating to voluntary withholding of income tax from annuity payments. Changes to the applicable tax law were made by the Tax Reform Act of 1969 [Pub. L. 91-172, 1969-3 C.B. 10] and the Act of December 24, 1980 (Pub. L. 96-601 [1980-2 C.B. 666]). The regulations provide guidance to payors and payees of annuities with respect to such withholding.

DATES: The regulations are effective for payments of annuities made after December 31, 1970.

FOR FURTHER INFORMATION CONTACT: Barry L. Wold of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3828).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On May 19, 1981, the FEDERAL REGISTER published proposed amendments to the Employment Tax Regulations (26 CFR Part 31) [LR-157-80, 1981-1 C.B. 766] under section 3402(o) of the Internal Revenue Code of 1954 (46 FR 27357). The regulations were proposed to conform the existing regulations to section 805(g) and (h)(3) of the Tax Reform Act of

1969 (83 Stat. 708, 709) and to the portions relating to annuities of section 4 of the Act of December 24, 1980 (Pub. L. 96-601; 94 Stat. 3495). The content of the proposed regulations, except for technical changes in titles, was identical to that of the Temporary Employment Tax Regulations under the Tax Reform Act of 1969 (26 CFR Part 32). Accordingly, 26 CFR Part 32 is deleted by this Treasury decision. A public hearing was not held, since one was not requested. After consideration of all comments regarding the proposed amendments, those amendments are adopted without change by this Treasury decision.

RESPONSE TO COMMENTS

Two comments relating to the notice of proposed rulemaking were received. One comment proposed that the minimum amount of tax to be withheld from a monthly annuity payment and the net amount of the annuity payment received by the payee below which tax may not be withheld both be increased ten-fold. This suggestion has not been adopted since such high minimums would eliminate the flexibility that the present regulations provide.

The other comment opposed the concept of withholding from annuities. These regulations, however, merely implement the clear mechanism that the Code provides for withholding from annuities. Congress has mandated withholding from annuities where the payee requests withholding, and the Service must implement that requirement.

Evaluation of the effectiveness of these regulations will be based on comments received from offices within the Treasury and the Internal Revenue Service, other governmental agencies, and the public. These regulations will impose no new reporting or recordkeeping requirements.

DRAFTING INFORMATION

The principal author of these regulations is Barry L. Wold of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, on matters of both substance and style.

Adoption of amendments to the regulations

Accordingly, the regulations proposed to be prescribed as final Employment Tax Regulations (26 CFR Part 31) published as a notice of proposed rulemaking in the Federal Register for May 19, 1981 (46 FR 27357), are hereby adopted as proposed. In addition, 26 CFR Part 32 is deleted.

Paragraph 1. Section 31.3402(o)-1 (relating to extension of withholding to certain payments other than wages) is amended by revising the caption for the section and for paragraph (a), to read as follows:

§31.3402(o)-1 Extension of withholding to supplemental unemployment compensation benefits.

(a) *In general.****

* * * * *

Par. 2. Section 32.1 (relating to extension of withholding of income tax at source on wages to annuity payments if requested by payee) is redesignated as §31.3402(o)-2, and such redesignated section is inserted after §31.3402(o)-1. Section 31.3402(o)-2 as so redesignated is amended by deleting the word "payer" and inserting the word "payor" in every place where the word "payer" appears, and by revising the caption for the section to read as follows:

§31.3402(o)-2 Extension of withholding to annuity payments if requested by payee.***

* * * * *

This Treasury decision is issued under the authority contained in sections 3402(o)(3) and (4) and 7805 of the Internal Revenue Code of 1954 (26 U.S.C. 3402(o)(3) and (4), 94 Stat. 3495; 26 U.S.C. 7805, 68A Stat. 917).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved January 15, 1982.

JOHN E. CHAPOTON,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 21, 1982, 4:21 p.m., and published in the issue of the Federal Register for January 26, 1982, 47 F.R. 3545)

---

26 CFR 31.3402(o)-3: Extension of withholding to sick pay.
(Also Section 6051; 31.6051-3.)

T.D. 7813

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 31.—EMPLOYMENT TAXES; APPLICABLE ON OR AFTER JANUARY 1, 1955; PART 35.—TEMPORARY EMPLOYMENT TAX REGULATIONS UNDER THE ACT OF DECEMBER 24, 1980 (PUB. L. 96-601)

Voluntary withholding from sick pay

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final Employment Tax Regulations (26 CFR Part 31) relating to voluntary withholding of income tax from sick pay. Changes to the applicable tax law were made by the Act of December 24, 1980 (Pub. L. 96-601 [1980-2 C.B. 666]). These regulations provide guidance to third party payors of sick pay, payees of sick pay, and employers of payees.

DATE: The regulations apply to sick pay payments made on or after May 1, 1981, by someone other than the employer for whom the payee performs services.

FOR FURTHER INFORMATION CONTACT: Barry L. Wold of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue N.W., Washington, D.C. 20224 (Attention CC:LR:T) (202-566-3828).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On May 1, 1981, the FEDERAL REGISTER published proposed amendments to the Employment Tax Regulations (26 CFR Part 31) under sections 3402(o) and 6051(f) of the Internal Revenue Code of 1954 (46 FR 24595) [LR-8-81, 1981-1 C.B. 766]. On the same date, the FEDERAL REGISTER also published Temporary Employment Tax Regulations Under the Act of December 24, 1980 (Pub. L. 96-601) under sections 3402(o) and 6051(f) of the Internal Revenue Code of 1954 (46 FR 24553) [T.D. 7773, 1981-1 C.B. 484]. A public hearing was held on August 11, 1981. After consideration of all comments regarding the proposed amendments, those amendments are adopted as revised by this Treasury decision.

RESPONSE TO MAJOR COMMENTS

Several comments requested that the deposit requirements of the regulations be clarified. Section 31.3402(o)-3(f) provides that the payor deposit amounts withheld under his own name and Employer Identification Number along with whatever amounts the payor withholds from his own employees. Employers report these amounts to employees on Forms W-2 that bear the employer's name and EIN. Concern was expressed about how these amounts would be reconciled. The final Form 941 of the year will contain details of the reconciliation procedure.

Another aspect of the regulations about which concern was expressed is the problems the statutory scheme presents to multiemployer plans under collective bargaining agreements. Two provisions have been added to the final regulations to ameliorate these problems. First, guidance has been provided as to the employer to whom these plans should provide the information reports. Second, an optional rule has been included to permit employers to designate the payor as the employer's agent for purposes of the reporting requirements of these regulations. Although primarily employers and plans in the collectively bargained multiemployer area were concerned about this issue, the regulation provides that any employer and payor may elect this treatment.

Some comments expressed the view that the standards for permanent and total disability are insufficiently clear. Section 31.3402(o)-3(h)(1)(i) of the final regulations states that if all amounts paid under a plan are described in the first sentence of section 105(d)(4), no amounts paid under that plan will be considered sick pay for purposes of these regulations. This narrower definition will lessen the burden upon payors—and thereby reduce their costs compared to complying with the definition in the temporary regulations—in determining whether amounts paid are sick pay or not, since payors will not need to make case-by-case determinations as to whether amounts paid are sick pay. Because withholding under these provisions is voluntary, a payee who determines that he is eligible for the partial exclusion of section 105(d) can reduce or eliminate withholding as his individual tax situation demands. A payee whose payments are subject to mandatory withholding under the terms of a collective bargaining agreement may stop that withholding if he is eligible for the partial exclusion under section 105(d). Because, however, some payors may have already acted in reliance upon the standards of the temporary regulations, the final regulations provide that a payor may, for 1981 only, opt to follow the standards of the temporary regulations.

Evaluation of the effectiveness of these regulations will be based on comments received from offices within the Treasury and the Internal Revenue Service, other governmental agencies, and the public.

DRAFTING INFORMATION

The principal author of these regulations is Barry L. Wold of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, on matters of both substance and style.

Adoption of amendments to the regulations

Accordingly, the Temporary Employment Tax Regulations Under the Act of December 24, 1980 (Pub. L. 96-601) (26 CFR Part 35) are deleted from the Code of Federal Regulations, and the following amendments are made to the Employment Tax Regulations (26 CFR Part 31):

Part 31—Employment Taxes; Applicable on or after January 1, 1955

Paragraph 1. A new §31.3402(o)-3 is added and is inserted after §31.3402(o)-2. New §31.3402(o)-3 reads as follows:

§31.3402(o)-3 Extension of withholding to sick pay.

(a) *In general.* Under section 3402(o) of the Internal Revenue Code of 1954 and this section, the payee (as defined in paragraph (h)(2) of this section) of sick pay (as defined in paragraph (h)(1) of this section) may request the payor (as defined in paragraph (h)(3) of this section) of the sick pay to withhold income tax with respect to payments of sick pay made on or after May 1, 1981. If such a request is made, the payor must deduct and withhold as requested.

(b) *Manner of making request.* A payee who wishes a payor to deduct and withhold income tax from sick pay shall file a written request with the payor to deduct and withhold a specific whole dollar amount (subject to the limitations of paragraph (c) of this section) from each sick pay payment. The request shall be made on Form W-4P in accordance with the instructions applicable thereto, and shall set forth fully and clearly the data therein called for. In lieu of Form W-4P, payors may prepare and use a form the provisions of which are identical to those of Form W-4P. The payee must include his social security account number in the request.

(c) *Amount requested to be withheld.* The payee shall request that the payor withhold a specific whole dollar amount. The specific whole dollar amount shall be at least $20 per weekly payment of sick pay. If the payee is paid sick pay computed on a daily basis, the specific whole dollar amount shall be at least $4 per daily payment of sick pay. If the payee is paid sick pay on a biweekly basis, the specific whole dollar amount shall be at least $40 per 2 week payment of sick pay. If the payee is paid sick pay on a semimonthly basis, the specific whole dollar amount shall be at least $44 per semimonthly payment of sick pay. If the payee is paid sick pay on a monthly basis, the specific whole dollar amount shall be at least $88 per monthly payment of sick pay. If the payee is paid sick pay on a basis other than weekly, daily, biweekly, semimonthly, or monthly, the specific whole dollar amount shall be the equivalent of at least $4 per day, assuming a 5 day work week of 8 hours per day (40 hours total) in each 7 day calendar week. In the case of a payment which is greater or less than a full payment, the amount withheld is to bear the same relation to the specific whole dollar amount requested to be withheld as such payment bears to a full payment. For example, assume an individual receives sick pay of $100 per week and requests that $25 per week be withheld for taxes. After 4 full weeks of absence, the individual returns to work on a Wednesday (having been absent on sick leave Monday and Tuesday). For the week the individual returns to work, the individual would be entitled to $40 of sick pay, $10 of which would be withheld for taxes. The payor may, at his option, permit the payee to request that the payor withhold a specific percentage from each payment. The specific percentage shall be at least 10 percent. If the payor so opts, the payor must also accept requests under the whole dollar method. If the amount requested to be withheld under either the whole dollar method or the optional percentage method reduces the net amount of a sick pay payment received by the payee to below $10, no income tax shall be withheld from that payment by the payor.

(d) *When request takes effect*. The payor must deduct and withhold the amount specified in the request with respect to payments made more than 7 days after the date on which the request is received by the payor. At the election of the payor, the request may take effect before this deadline.

(e) *Duration and termination of request*. A request under this section shall continue in effect until changed or terminated. The payee may change the request by filing a new written request that meets all the requirements of paragraphs (b) and (c) of this section. The new request shall take effect as specified in paragraph (d) of this section and the old request shall be deemed terminated when the new request takes effect. The payee may terminate the request by furnishing the payor a signed written notice of termination containing both a request to terminate withholding and all the information contained in the request to withhold. This written notice of termination shall take effect with respect to payments made more than 7 days after the date on which the notice of termination is received by the payor. At the election of the payor, the request may take effect before this deadline.

(f) *Special rules*. For purposes of chapter 24 on subtitle C of the Internal Revenue Code of 1954 (relating to collection of income tax at source on wages) and of subtitle F of the Code (relating to procedure and administration), and the regulations thereunder—

(1) An amount which is requested to be withheld pursuant to this section shall be deemed a tax required to be deducted and withheld under section 3402.

(2) An amount deducted and withheld pursuant to this section shall be deemed an amount deducted and withheld under section 3402.

(3) The term "wages" includes the gross amount of a sick pay payment with respect to which there is in effect a request for withholding under this section. However, references to the definition of wages in section 3401(a) which are made in section 6014 (relating to election by the taxpayer not to compute the tax on his annual return) and section 6015(a) (relating to declaration of estimated tax by individuals) shall not be deemed to include any portion of such a sick pay payment.

(4) The term "employer" includes a payor with respect to whom a request for withholding is in effect under this section.

(5) The term "employee" includes a payee with respect to whom a request for withholding is in effect under this section.

(6) The term "payroll period" includes the period of accrual with respect to which payments of sick pay which are subject to withholding under this section are ordinarily made.

(g) *Statements required to be furnished to payees*. See section 6051(f) and the regulations thereunder for requirements relating to statements required to be furnished to payees.

(h) *Definitions*. (1)(i) The term "sick pay" means any payment made to an individual which does not constitute wages (determined without regard to section 3402(o) and this section), which is paid to an employee pursuant to a plan to which the employer is a party, and which constitutes remuneration or a payment in lieu of remuneration for any period during which the employee is temporarily absent from work on account of personal injuries or sickness. The term "personal injuries or sickness" shall have the same meaning as ascribed thereto by section 105(a) and the regulations thereunder. The term "sick pay" does not include any amounts either excludable from gross income under section 104(a)(1), (2), (4) or (5) or section 105(b) or (c) or paid under section 3402(o)(1)(B). The term "sick pay" does not include amounts paid under a plan if all amounts paid under the plan are paid to individuals who are described in the first sentence of section 105(d)(4) (relating to the definition of permanent and total disability) and the regulations thereunder. Amounts paid under any other plan shall be deemed to be paid for a period during which the employee is temporarily absent from work. For sick pay paid in 1981 only, however, the payor may opt not to follow the rules of the two preceding sentences but to follow instead the rule that an employee is temporarily absent if his absence is not described in section 105(d)(4) (relating to the definition of permanent and total disability) and the regulations thereunder. An employer is not a party to the plan if the plan is a contract between only employees and a third party payor or the employer makes no contributions to provide sick pay benefits under the plan, even if the employer withholds amounts from the employees' salaries and pays the amounts over to the third party payor.

(ii) This subparagraph (1) may be illustrated by the following examples:

Example (1). Employee A works for P Company and Employee B works for Q Company. P Company has contracted with R Insurance Company for R to pay P's employees the equivalent of their normal wages when they are temporarily absent from work because of sickness or personal injury. Q Company has neither entered into such a contract, nor will it make such payments directly from it own funds. B consequently goes to S Insurance Company and purchases directly an insurance policy which will pay him the equivalent of his normal wages when he is unable to work because of sickness or personal injury. Both A and B are subsequently temporarily absent from work on account of sickness or personal injuries. A receives payments from R and B receives payments from S. Neither the payments made by R to A nor the payments made by S to B constitute wages (determined without regard to section 3402(o) and this section). A may request that R withhold income taxes under section 3402(o) and this section from the payments he receives because the payments are sick pay as defined in section 3402(o) and this section. B may not request that S withhold income taxes under section 3402(o) and this section from the payments he receives because the payments are not paid pursuant to a plan to which Q Company is a party and thus are not sick pay as defined in section 3402(o) and this section.

Example (2). Employees C and D both work for T Company, which has contracted with U Insurance Company for U to pay T's employees for all sickness or injury claims. Employee C is sick and out from work for a month. U pays C the equivalent of C's regular pay. Employee D loses his arm in an accident and U pays D $10,000. C may request that U withhold income taxes under section 3402(o) and this section from the payments he receives because the payments constitute remuneration or a payment in lieu of remuneration for any period during which the employee is temporarily absent from work on account of sickness or personal injuries. D may not request that U withhold income taxes from the payments he receives because the payments do not constitute remuneration or a payment in lieu of remuneration for any period during which the employee is temporarily absent from work on account of sickness or personal injuries.

(2) The term "payee" means an individual who is a citizen or resident of the United States and who receives a sick pay payment.

(3)(i) The term "payor" means any person making a sick pay payment who is not the employer (as defined in section 3401 and in §31.3401(d)-1 (except paragraph (f) thereof)) of the payee. If however the person making the payment is acting solely as an agent for another person, the term "payor" shall mean the other person and not the person actually making the payment.

(ii) This subparagraph (3) may be illustrated by the following examples:

Example (1). X Company contracts with Y Insurance Company for Y to pay X's employees the equivalent of their normal wages when they are temporarily absent from work because of sickness or personal injury. Y computes the amount to be paid and determines the date payment is to be made for each of X's employees. Y then instructs Z Bank to issue a check for that amount on that date. Y reimburses Z for the amount of the check plus Z's administrative costs. Under these circumstances, Z is the agent of Y and Y is the payor under section 3402(o) and this section.

Example (2). V Company contracts with W Company for W to pay V's employees the equivalent of their normal wages when they are temporarily absent from work on account of sickness or personal injury. Under the contractual arrangement, V advises W of the wages normally paid to each of V's employees. V tells W when an employee of V is temporarily absent from work on account of sickness or personal injury, and W computes the amount to be paid the employee and makes payments of sick pay to the employee during the period of the employee's absence. V subsequently reimburses W for the amount of those payments and pays W a fee for W's services. Under these circumstances, W is acting solely as the agent of V, and a payee may not request under section 3402(o) and these regulations that W withhold income taxes from his payments. However, see section 3401 and the regulations thereunder for the obligation of V to withhold income taxes from the payments that W makes as the agent of V, which are not excluded from income under section 105 and the regulations thereunder and which are wages under section 3401 and the regulations thereunder. See also §31.3402(g)-1 (relating to supplemental wage payments) for the conditions under which a flat percentage rate of withholding may be used.

Example (3). Assume the same facts as in Example (2), except that the consideration for W's services is a set insurance premium rather than reimbursement for costs plus a fee. Under these circumstances W is the payor and is not acting as the agent of V. An employee of V to whom W makes payments under the agreement may request under section 3402(o) and the regulations thereunder that W withhold income taxes from those payments.

(i) *Special rules for sick pay paid pursuant to certain collective-bargaining agreements.* (1) Special rules (enumerated in subparagraph (2)) apply to sick pay where all of the following tests are met.

(i) The sick pay must be paid pursuant to a collective-bargaining agreement between employee representatives and one or more employers.

(ii) The agreement must contain a provision that section 3402(o)(5) is to apply to sick pay paid pursuant to the agreement.

(iii) The agreement must contain a provision for determining the amount to be deducted and withheld from each payment of sick pay.

(iv) The social security number of the payee must be furnished to the payor. The agreement may provide that the employer will furnish this or the payee may furnish his social security number directly to the payor.

(v) The payor must be furnished with information that is necessary for the payor to determine whether the payment is pursuant to the agreement and to determine the amount to be deducted and withheld. The agreement may provide that the employer will furnish this information directly to the payor.

(2) The following special rules apply to sick pay where all of the tests of subparagraph (1) are met.

(i) The requirement of section 3402(o)(1)(c) and this section that a request for withholding be in effect does not apply.

(ii) The amount to be deducted and withheld from the sick pay shall be determined according to the provisions of the agreement and not according to this section. This rule shall not however apply—

(A) To payments enumerated in section 3402(n) (relating to employees incurring no income tax liability) and the regulations thereunder, or

(B) To payments made to a payee more than 7 days after the date that the payor receives a statement from the payee that the payee expects to claim an exclusion from gross income under section 105(d). Such statement must include adequate verification of disability. A certificate from a qualified physician attesting that the employee is permanently and totally disabled (within the meaning of section 105(d)) shall be deemed to constitute adequate verification. If the payor receives such a statement, the payor shall not withhold any income tax from the payments made to the payee, regardless of the provisions of the collective-bargaining agreement. This exception from withholding does not affect the requirements of §31.6051-3.

Par. 2. A new §31.6051-3 is added and is inserted after §31.6051-2. New §31.6051-3 reads as follows:

§31.6051-3 Statements required in case of sick pay paid by third parties.

(a) *Statements required from payor.* (1) Every payor of sick pay shall furnish to the employer of the payee of the sick pay a written statement. The written statement must contain the following information:

(i) The name and, if there is withholding from sick pay under section 3402(o) and the regulations thereunder, the social security account number of the payee,

(ii) The total amount of sick pay paid to the payee during the calendar year, and

(iii) The total amount (if any) deducted and withheld from sick pay under section 3402(o) and the regulations thereunder.

The statement must be furnished to the employer on or before January 15 of the year following the calendar year in which any sick pay was paid.

(2) These reporting requirements are in lieu of the requirements of sections 6051(a) (relating to written statements for employees) and 6041 (relating to information returns). Statements required to be furnished by this paragraph shall be treated as statements required under section 6051 to be furnished to employees for purposes of sections 6674 (relating to fraudulent statement or failure to furnish statement to employee) and 7204 (relating to fraudulent statement or failure to make statement to employees).

(3) A multiemployer plan paying sick pay pursuant to a collectively bargained agreement may furnish the statement required to be furnished by this paragraph, which shall include the total amount of sick pay paid to the employee under the plan regardless of the identity or number of employers for whom the employee worked during the calendar year under the plan, to one of the following.

(i) The employer for whom the employee worked the most hours during the calendar year for which the statement is to be furnished,

(ii) The employer for whom the employee first worked during such year,

(iii) The employer for whom the employee last worked during such year,

(iv) The employer for whom the employee worked immediately preceding his absence for which sick pay was paid,

(v) The employer for whom the employee worked immediately following his absence for which sick pay was paid,

(vi) The employer designated through the operation of a specific clause of the collective-bargaining agreement, or

(vii) The employer designated through the operation of a specific system of designation chosen by the payor.

(b) *Information required to be furnished by employer.* Every employer of a payee of sick pay who receives a statement under paragraph (a) from a payor of sick pay shall furnish to each payee of sick pay a written statement, which must be furnished on Form W-2. The written statement must contain the following information:

(1) All of the information required to be furnished under paragraph (a),

(2) The name, the address, and the Employer Identification Number (EIN) of the employer,

(3) The words "sick pay", which shall be written in the box labelled "Employer's Use", and

(4) If any portion of the sick pay is excludable from gross income under section 104(a)(3), the amount of the portion which is not so excludable and of the portion which is so excludable. Only sick pay payments includable in gross income shall be reported in the box labelled "Wages, tips, other compensation" on Form W-2. Any amount excludable from gross income under section 104(a)(3) shall be reported in the box labelled "Employer's Use" on Form W-2 and any amount so reported shall be described as "Nontaxable". The information required to be furnished by this paragraph may be furnished either on the same Form W-2 that is required to be furnished under section 6051(a) or on a separate Form W-2. To the extent practicable, this statement should be furnished to the payee along with the statement (if any) required under section 6051(a) (relating to written statements for employees). The statement must be furnished to the payee on or before January 31 of the year following the calendar year in which any sick pay was paid. The employer shall file copy A of Form W-2 and Form W-3 with the Social Security Administration in accordance with section 6051(d) (relating to statements to constitute information returns) and the regulations thereunder.

(c) *Optional rule.* The payor and the employer may at their option enter into an agency agreement valid under local law whereby the employer designates the payor to be the employer's agent for purposes of fulfilling the requirements of this section. This agreement must specify what portion, if any, of the sick pay is excludable from gross income under section 104(a)(3). If they enter into such an agreement, the payor shall not provide the statement required by paragraph (a) but shall instead furnish statements that meet all of the requirements of paragraph (b), except that the agreement must provide that the payor will furnish the statements with the payor's, rather than the employer's name, address, and Employer Identification Number (EIN) if "Sick Pay Statement Furnished under an Agency Agreement with Your Employer" appears in the box labelled "Employer's Use" on Form W-2. Paragraph (a)(2) remains applicable to statements furnished under this paragraph. In the case of sick pay paid under a multiemployer plan pursuant to a collectively bargained agreement, an amendment to either the multiemployer plan or the collectively bargained agreement designating the payor to be the employers' agent for purposes of fulfilling the requirements of this section shall be deemed an agency agreement that fulfills the requirements of the first sentence of this paragraph.

(d) *Definitions.* For purposes of this section, the terms "payor", "payee", and "sick pay" shall have the same meaning as ascribed thereto in section 3402(o) and the regulations thereunder. For purposes of this section, the term "employer" shall have the same meaning as ascribed thereto in section 3401(d) and the regulations thereunder, except that the term "employer" shall not include the payor for purposes of this section.

(e) *Additional requirements.* (1) Statements furnished to payees under this section must also comply with all requirements of section 6051(c) and (d) and the regulations thereunder.

(2) The provisions of §1.9101-1 (relating to permission to submit information required by certain returns and statements on magnetic tape) shall be applicable to the information required by this section to be furnished on Form W-2 if the employer properly complies with those provisions.

(3) The provisions of section 6109 (relating to identifying numbers) and the regulations thereunder shall be applicable to Form W-2 and to any payee of sick pay to whom a statement on Form W-2 is required by this section to be furnished. Thus the employer must include the social security account number of the payee on all Forms W-2.

(f) *Effective date.* The provisions of this section shall apply to payments of sick pay made on or after May 1, 1981.

(g) *Transitional rule.* Payors may report all sick pay paid to a payee after December 31, 1980, and before May 1, 1981, on the same statement required to be furnished under paragraph (a) as is used to report sick pay paid to a payee on or after May 1, 1981. If the payor reports on the statement required to be furnished under paragraph (a), he shall not report sick pay paid after December 31, 1980, and before May 1, 1981, on Form 1099, if otherwise required to do so. If no sick pay is paid on or after May 1, 1981, the payor may report all sick pay paid to a payee after December 31, 1980, and before May 1, 1981, on the statement required to be furnished under paragraph (a). If he reports on the statement required to be furnished under paragraph (a), he shall not report sick pay on Form 1099, if otherwise required to do so.

Part 35—Temporary Employment Tax Regulations Under the Act of December 24, 1980 (Pub. L. 96-601)

§§35.1 and 35.2 [Removed]

Par. 3. Sections 35.1 and 35.2 and Part 35 are hereby removed.

This Treasury decision is issued under the authority contained in sections 3402(o) and 7805 of the Internal Revenue Code of 1954 (94 Stat. 3495, 26 U.S.C. 3402(o); 68A Stat. 917, 26 U.S.C. 7805).

ROSCOE L. EGGER, JR.
Commissioner of Internal Revenue.

Approved March 8, 1982.

JOHN E. CHAPOTON,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on March 15, 1982, 8:45 a.m., and published in the issue of the Federal Register for March 16, 1982, 47 F.R. 11275)

---

26 CFR 31.3402(p)-1: Extension of withholding to certain gambling winnings.

Requirements and conditions for the printing of substitutes for information returns in the Forms 1087 and 1099 series and W-2G. See Rev. Proc. 82-5, page 406.

Section 3403.—Liability for Tax

26 CFR 31.3403-1: Liability for tax.

Whether a corporation that treats its officers as independent contractors rather than as employees is entitled to relief under section 530 of the Revenue Act of 1978. See Rev. Rul. 82-83, page 151.

---

26 CFR 31.3403-1: Liability for tax.

Whether a taxpayer is entitled to relief under section 530 of the Revenue Act of 1978 for not treating alien agricultural workers as employees. See Rev. Rul. 82-116, page 152.

Subtitle D.—Miscellaneous Excise Taxes
Chapter 31.—Special Fuels

Section 4041.—Imposition of Tax

26 CFR 48.4041-11: Sales to States or political subdivisions thereof.
(Also Sections 4221, 4253, 4483, 7805; 48.4221-5, 41.4483-1, 301.7805-1.)

State or local government exemption: community action organization. Excise tax exemptions for state or local governments do no apply in the case of a nonprofit community action organization conducting antipoverty programs with grants from the Federal Government. Rev. Rul. 68-274 revoked.

Rev. Rul. 82-30

ISSUE

Does the nonprofit community action organization (the organization) described below come within the scope of the federal excise tax exemptions for states and local governments?

FACTS

The organization was incorporated under state law as a nonprofit corporation. The objective of the organization is to eliminate poverty (or causes of poverty) by developing employment opportunities; by improving individual motivation, performance, and productivity; and by bettering the conditions under which people live, learn, and work. Other voluntary or governmental organizations in the community that operate or sponsor programs geared to the elimination of poverty, and that otherwise meet any affiliation requirements established by the organization under consideration here, are eligible to affiliate with this organization in an advisory or consultative capacity.

Grants made available by the federal government provide a portion of the organization's financial needs, with the balance being provided by contributions from the local community. The organization's programs must be approved by the Community Services Administration, which was established under the Headstart, Economic Opportunity, and Community Partnership Act of 1974 to administer federal funding of such programs. The organization's board of directors is responsible for, and determines by majority vote, its fiscal and administrative policies. The board consists of 24 members. Eight members are elected from and by the local community groups that the organization's program is intended to serve. Eight members are public officials designated by the participating jurisdictions or are individuals from independent public agencies. The last eight members are selected by the board from educational, social, religious, or business groups within the communities. In carrying out its program proposals submitted to and approved by the Community Services Administration, the organization subcontracts with public and private institutions to perform services that correspond to the program proposals.

LAW AND ANALYSIS

Section 4041(g)(2) of the Internal Revenue Code exempts from the taxes on diesel and special fuels imposed by section 4041 sales for the exclusive use of any state, political subdivision or the District of Columbia. Comparable exemptions from the manufacturers excise taxes, the tax on communications, and the highway use tax are provided by sections 4221(a)(4), 4253(i) and 4483(a), respectively.

In determining whether a sale to, or use by, an organization is for the exclusive use of a state or local government, it must be established that the organization is either (a) controlled, directly or indirectly, by an agency of a state or local government, or (b) is performing a traditional governmental function on a nonprofit basis. *See* Rev. Rul. 70-214, 1970-1 C.B. 230; Rev. Rul. 71-485, 1971-2 C.B. 371; Rev. Rul. 74-253, 1974-1 C.B. 316.

Ordinarily an organization will not be considered to be performing a traditional governmental function for purposes of the exemption unless it is performing an essential governmental function that state or local governments generally have performed directly and that would have to be carried on by the state or local government if the organization did not exist. The term traditional governmental function does not include activities of an organization merely because they are of the type that could appropriately be carried on by a state or local government if it chose to do so, or merely because they supplement existing government activities. The separate exemptions provided for hospitals (section 4253(h)) and schools (sections 4041(g)(4), 4221(a)(5), and 4253(j)) make clear that the state and local government exemptions were not intended to apply to every organization that performs an important social or charitable function that is also sometimes performed by government.

The organization in question is not controlled directly or indirectly by a state or local government authority since its fiscal and administrative policies are formulated and controlled by a board of directors that is independent of such authority. The board members that are public officials or individuals from independent public agencies do not have authority that indicates control by a state or local political subdivision.

In addition, the programs of the organization directed at the elimination of poverty are quite unlike the usual programs by which state or local governments have assisted the indigent in meeting their basic needs. State and local governments traditionally have provided only money and in kind benefits, rather than programs directed to improving economic abilities and motivation.

HOLDING

When taxable articles are sold to the organization or when taxable communication services and facilities are furnished to the organization, the excise tax exemptions provided by sections 4041(g)(2), 4221(a)(4), and 4253(i) of the Code do not apply since such transactions are not for the exclusive use of a state or local government. Further, the exemption from the highway use tax provided by section 4483(a) does not apply to the operation of vehicles by the organization.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 68-274, 1968-1 C.B. 449, holds that a substantially similar nonprofit community organization is entitled to tax exemption under sections 4055, 4221(a)(4), and 4292 on the basis that the activities of the organization are functions traditionally associated with state or local governments.

However, under the rationale of this present revenue ruling, the organization described in Rev. Rul. 68-274 is not entitled to the tax exemptions presently provided in sections 4041 (g)(2), 4221(a)(4), 4253(i) and 4483(a).

Rev. Rul. 68-274 is revoked.

NONRETROACTIVE APPLICATION

Under the authority contained in section 7805(b) of the Code, the conclusion in this revenue ruling will not be applied before July 1, 1982.

---

26 CFR 48.4041-11: Sales to States or political subdivisions thereof.
(Also Sections 4221, 4253, 4483, 6416; 48.4221-5, 41.4483-1, 48.6416(b)-2.)

State or local government exemption; parent-teachers association. Excise tax exemptions for state and local governments do not apply to articles that are sold to a parent-teachers association and then donated to a state school. Also, the donation of the articles does not establish a basis for a credit or refund of the tax paid on the article. Rev. Rul. 58-107 superseded.

Rev. Rul. 82-31

ISSUE

Does the sale to the nonprofit parent-teachers association described below come within the scope of the federal excise tax exemptions for states and local governments?

FACTS

A taxable article was sold to a local unit of the parent-teachers association, which in turn donated the article to a state-operated school. The association, consisting of a local group of teachers and their students' parents, works to improve the school and to benefit the students. The association is controlled by the members and managed by their elected officers. It possesses financial autonomy and is the source of its operating funds. The association provides funds, materials, and various services that supplement the school's existing programs and provide additional benefits for the students.

LAW AND ANALYSIS

Section 4041(g)(2) of the Internal Revenue Code exempts from the taxes on diesel and special fuels imposed by section 4041 sales for the exclusive use of any state, political subdivision or the District of Columbia. Comparable exemptions from the manufacturers excise taxes, the tax on communications, and the highway use tax are provided by sections 4221(a)(4), 4253(i), and 4483(a).

In determining whether a sale to, or use by, an organization is for the exclusive use of a state or local government, it must be established that the organization is either (a) controlled, directly or indirectly, by an agency of a state or local government, or (b) is performing a traditional governmental function on a nonprofit basis. See Rev. Rul. 70-214, 1970-1 C.B. 230; Rev. Rul. 71-485, 1971-2 C.B. 371; Rev. Rul. 74-253, 1974-1 C.B. 316.

Ordinarily an organization will not be considered to be performing a traditional governmental function for purposes of the exemption unless it is performing an essential governmental function that state or local governments generally have performed directly and that would have to be carried on by the state or local government if the organization did not exist. The term traditional governmental function does not include activities of an organization merely because they are of the type that could appropriately be carried on by a state or local government if it chose to do so, or merely because they supplement existing government activities. The separate exemptions provided for hospitals (section 4253(h)) and schools (section 4041(g)(4), 4221(a)(5), and 4253(j)) make clear that the state and local government exemptions were not intended to apply to every organization that performs an important social or charitable function that is also sometimes performed by government. See Rev. Rul. 82-30, page 165, this Bulletin.

A parent-teachers association is not controlled directly or indirectly by a state or local government authority when its fiscal and administrative policies are formulated and controlled by its members who are independent of that authority.

Further, the parent-teachers association is not performing an essential governmental function that state and local governments generally have performed directly and that would have to be carried on by the government if the association did not exist. Although the programs of the association are of the type that could appropriately be carried on by the government, they are unlike the usual programs that are operated by the government. The association's activities are directed to supplementing existing state school programs and providing additional benefits for the students.

HOLDING

When taxable articles are sold to the parent-teachers association or when taxable communications services and facilities are furnished to the association, the excise tax exemptions provided by sections 4041(g)(2), 4221(a)(4), and 4253(i) of the Code do not apply because these transactions are not for the exclusive use of a state or local government. Further, the exemption from the highway use tax provided by section 4483(a) does not apply to the operation of vehicles by the association.

Section 6416(b)(2)(C) of the Code allows a credit or refund of the tax paid on articles sold to a state or local government for the exclusive use of a state or local government. However, this section does not establish a basis for a credit or refund on the later donation of an article by the association to the school because this would not be a sale to a state or local government.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 58-107, 1958-1 C.B. 429, holds that a substantially similar organization is not entitled to the excise tax exemption under former section 4224 of the Code because the sale of taxable articles was not direct to a state or local government. Under this revenue ruling the organization described in Rev. Rul. 58-107 also would not be entitled to the tax exemptions presently provided in sections 4041(g)(2), 4221(a)(4), 4253(i) and 4483(a).

Rev. Rul. 58-107 is superseded.

Chapter 32.—Manufacturers Excise Taxes
Subchapter A.—Automotive and Related Items
Part I.—Motor Vehicles

Section 4061.—Imposition of Tax

26 CFR 48.4061(a)-1: Imposition of tax; exclusion for light-duty trucks, etc.
(Also Sections 4217, 4221; 48.4217-2, 48.4221-3.)

Leased trucks; sold in U.S. after use overseas. The tax imposed by section 4061 of the Code applies to the manufacturer's sale to a dealer of trucks that, when new, had been leased by the manufacturer to a U.S. agency for use in a foreign country. Rev. Rul 56-375 superseded. Rev. Rul. 81-97 distinguished.

Rev. Rul. 82-7

ISSUE

Does the manufacturers excise tax imposed by section 4061(a)(1) of the Internal Revenue Code apply under the circumstances described below?

FACTS

A truck manufacturer, regularly engaged in selling its trucks in arm's length transactions, shipped new trucks to a foreign country for delivery under lease to a United States agency operating in a foreign country. The agency used the trucks in the foreign country during the period of the lease. Upon expiration of the lease, the manufacturer disposed of some of the trucks in the foreign country, and returned the others to the United States and sold them to an unrelated dealer.

LAW AND ANALYSIS

Section 4061(a) of the Code imposes a tax on the sale by the manufacturer, producer, or importer of certain enumerated articles, including automobile truck chassis and bodies.

Section 4217(a) of the Code provides

that for purposes of the manufacturers excise taxes imposed under chapter 32 (which includes section 4061), the lease of an article (including any renewal or any extension of a lease or any subsequent lease of such article) by the manufacturer, producer, or importer is considered to be a sale of such article. Section 4217(d)(2) provides rules for determining the amount of tax payable upon the sale of an article by the manufacturer where the manufacturer has previously leased such article under a taxable lease.

Section 4221(a)(2) of the Code provides that no manufacturers excise tax will be imposed on the sale by the manufacturer of an article for export.

Rev. Rul. 56-375, 1956-2 C.B. 818, holds, under prior law, that the manufacturers excise tax does not apply to payments received by a manufacturer for the lease of articles to a United States agency operating in a foreign country provided the articles remained in a foreign country during the period of the lease and are disposed of in a foreign country on expiration of the lease.

Rev. Rul. 81-97, 1981-1 C.B. 498, holds that an importer's sale of taxable articles previously sold tax free for export and exported are not subject to manufacturers excise tax where the articles are used prior to being returned to the United States.

Rev. Rul. 80-256, 1980-2 C.B. 308, holds that the tax imposed by section 4061(a)(1) of the Code applies to a manufacturer's retail sale of a truck that when new had been leased to a school under a lease that is not taxable by reason of the exemption provided by section 4221(a)(5). The language of section 4217(d) indicates that a lease of an article does not insulate a later sale of such article from manufacturers excise tax because that section provides rules for determining the amount of tax due upon a sale of an article following a taxable lease of such article. Under Rev. Rul. 80-256, the fact that the lease that occurred prior to the sale is an exempt lease does not remove the sale from the scope of sections 4061(a)(1) and 4217.

The payments received by the manufacturer for the lease of the trucks are not subject to the tax under section 4061(a)(1) of the Code by reason of the exemptions provided by section 4221(a)(2). However, unlike the sale of a used article that was previously sold tax-free, the tax-free lease of an article would not insulate its later sale from tax.

HOLDING

The tax imposed by section 4061(a)(1) of the Code applies to the manufacturer's sale of the used trucks to the dealer. The basis for computing the tax is the actual selling price to the dealer.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 56-375 is superseded.

Rev. Rul. 81-97 is distinguished.

---

26 CFR 48.4061(a)-1: Imposition of tax; exclusion for light-duty trucks, etc.

Whether manufacturers excise tax applies to a manufacturer's retail sale of a part or accessory to a purchaser who simultaneously purchases a tax-exempt light-duty vehicle from another vendor. See Rev. Rul. 82-19, page 169.

---

26 CFR 48.4061(a)-1: Imposition of tax; exclusion for light-duty trucks, etc.

Whether a device that enables rubber-tired vehicles to move on railroad tracks is a taxable automotive part or accessory. See Rev. Rul. 82-52, page 168.

---

26 CFR 48.4061(b)-1: Imposition of tax.

Who may properly claim a credit or refund of tax paid on the sale of an automotive part or accessory used in the manufacture of another article? See Rev. Rul. 82-14, page 210.

---

26 CFR 48.4061(b)-2: Definition of parts or accessories.
(Also Section 48.4061(a)-1.)

Parts or accessories; railroad track guide wheels for highway vehicles. The manufacturers excise tax does not apply to a device that enables rubber-tired vehicles to move on railroad tracks. Rev. Rul. 63-186 revoked.

Rev. Rul. 82-52

ISSUE

Is a device that enables rubber-tired vehicles to move on railroad tracks an automotive part or accessory subject to the tax imposed by section 4061(b)(1) of the Internal Revenue Code?

FACTS

The Internal Revenue Service has reconsidered Rev. Rul. 63-186, 1963-2 C.B. 494, which involves the application of the manufacturers excise tax to a device that basically consists of two pairs of flanged steel wheels that may be attached to the front and rear of an automobile, truck, or other rubber-tired vehicle. When lowered, the flanged wheels keep the tires of the vehicle centered on the railroad tracks and thus permit operation of the vehicle on the tracks. The flanged wheels are raised when the vehicle is to be operated on the highway. The device does not impair the traction, braking, and other operating features of the vehicle. It is used most often with a vehicle that transports personnel for the inspection or maintenance of railroad lines.

Rev. Rul. 63-186 holds that the device is an automobile part or accessory subject to the manufacturers excise tax imposed by section 4061(b)(1) of the Code.

LAW AND ANALYSIS

Section 4061(a)(1) of the Code imposes a tax on automobile truck chassis and bodies, including parts or accessories sold on or in connection with them or with their sale.

Section 4061(b)(1) of the Code imposes a separate tax on parts or accessories for any of the articles specified in section 4061(a)(1) sold by the manufacturer, producer, or importer, but not sold on or in connection with the articles or with their sale.

Under section 48.4061(a)-1(a)(3)(ii)(A) of the Manufacturers and Retailers Excise Tax Regulations, amounts charged for machinery or equipment that is installed on a taxable chassis or body are not part of the taxable sale price of the chassis or body if the machinery or equipment does not contribute toward the highway transportation function of the chassis or body.

Under section 48.4061(b)-2(a) of the regulations, the term "parts or accessories" includes (1) any article the primary use of which is to improve, repair, replace, or serve as a component part of an automobile truck chassis or body, (2) any article designed to be attached to or used in connection with such chassis or body to add to its utility or ornamentation, and (3) any article the primary use of which is in connection with such chassis or body, whether or not essential to its operation or use.

Although the device in this case is designed to be attached to a taxable motor vehicle to add to its utility, the device does not contribute to the highway transportation function of the vehicle. Accordingly, if it were sold installed on a taxable vehicle as original equipment, it would be excluded under section 48.4061(a)-1(a)(3)(ii) of the regulations from the tax imposed by section 4061(a)(1) of the Code. Therefore, it follows that when sold separately, the device should not be subject to the tax imposed by section 4061(b)(1) of the Code because it performs no highway transportation function, even though it may otherwise meet the definition of a part or accessory under section 48.4061(b)-2(a).

See Rev. Rul. 76-117, 1976-1 C.B. 338, which holds that retractable stabilizing or supporting jacks that are designed to be permanently attached to truck chassis or bodies to be used in connection with nontaxable equipment mounted on the vehicles are not automotive parts or accessories subject to the tax imposed by section 4061(b)(1) of the Code. Rev. Rul. 76-117 distinguishes such jacks from other stabilizing jacks held taxable in Rev. Rul. 70-213, 1970-1 C.B. 224, on the basis that the jacks in Rev. Rul. 70-213 are used to stabilize trucks and truck trailers during loading and unloading operations and thus perform a function relating to the transportation of property over the highway.

HOLDING

The device is not an automotive part or accessory subject to the manufacturers excise tax imposed by section 4061(b)(1) of the Code because it does not contribute to the vehicle's highway transportation function.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 63-186 is revoked.

Section 4063.—Exemptions

(Also Section 4061; 48.4061(a)-1.)

Parts for light duty trucks; exemptions; sales at retail. The exemption provided by section 4063(e) of the Code applies to the manufacturer's retail sale of a part or accessory to a customer for installation on a light duty vehicle simultaneously purchased by the customer from another vendor. Rev. Rul. 81-130 amplified.

Rev. Rul. 82-19

ISSUE

Does the excise tax exemption provided by section 4063(e) of the Internal Revenue Code apply to a manufacturer's retail sale of a part or accessory to a customer for installation on a tax-exempt light-duty vehicle simultaneously purchased by the customer from a dealer.

FACTS

A manufacturer of truck parts and accessories sells a taxable part at retail to a customer who installs the part on a new light-duty truck the customer simultaneously purchased from a dealer. The light-duty truck is not subject to manufacturers excise tax by reason of the exemption provided by section 4061(a)(2) of the Code.

LAW AND ANALYSIS

Section 4061(a)(1) of the Code imposes a tax on the sale by the manufacturer, producer, or importer of certain enumerated motor vehicle articles, including automobile truck chassis.

Section 4061(a)(2) of the Code excludes from the tax imposed by section 4061(a)(1) sales by the manufacturer, producer, or importer of automobile truck chassis or bodies suitable for use with a vehicle having a gross vehicle weight of 10,000 pounds or less.

Section 4061(b)(1) of the Code imposes a tax on parts or accessories (other than tires and inner tubes) for any of the articles enumerated in section 4061(a)(1) when sold by the manufacturer, producer, or importer.

Section 4063(e) of the Code provides that the tax on automotive parts or accessories imposed by section 4061(b) shall not apply to the sale by the manufacturer of any article that is to be resold by the purchaser on or in connection with the first retail sale of a light-duty truck, as described in section 4061(a)(2), or that is to be resold by the purchaser to a second purchaser for resale by such second purchaser on or in connection with the first retail sale of a light-duty truck.

Rev. Rul. 81-130, 1981 C.B. 499, modifies Rev. Rul. 78-33, 1978-1 C.B. 342, to provide that under section 4063(e) of the Code a manufacturer can sell a part or accessory tax free to a dealer for resale to a trucking operator who is simultaneously purchasing a tax-exempt light-duty truck from another dealer. The trucking operator must provide to the seller of the part or accessory, in connection with such purchase, documentary evidence of a substantially contemporaneous purchase of a light-duty truck and a written certification that the part or accessory is purchased for use on the truck.

As in Rev. Rul. 81-130, the sales of the light-duty truck and the part or accessory in the present case are the first retail sales of both articles. Unlike the situation in Rev. Rul. 81-130, however, the manufacturer in the present case is selling the part or accessory directly to the customer for installation on a newly-purchased light-duty truck.

Although section 4063(e) of the Code provides that, in order to be exempt, the sale of the part or accessory is to be for resale on or in connection with the first retail sale of a light-duty truck, this was not meant to preclude the availability of the exemption where a sale is made by the manufacturer not for resale but directly to the ultimate user.

HOLDING

The manufacturers excise tax exemption provided by section 4063(e) of the Code applies to the manufacturer's retail sale of the part or accessory, provided the customer furnishes to the manufacturer documentary evidence of a substantially contemporaneous purchase of a light-duty truck and a written certification that the part or accessory is purchased for use on the truck.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 81-130 is amplified.

Part II.—Tires and Tubes

Section 4071.—Imposition of Tax

26 CFR 48.4071-1: Imposition and rates of tax.

T.D. 7809

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PART 48—MANUFACTURERS AND RETAILERS EXCISE TAXES; PART 142—TEMPORARY EXCISE TAX REGULATIONS UNDER THE REVENUE ACT OF 1971; PART 144—TEMPORARY EXCISE TAX REGULATIONS RELATING TO TAX ON TIRES AND TUBES DELIVERED TO MANUFACTURER'S RETAIL OUTLET

Manufacturers excise tax on tires, tubes and tread rubber

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final excise tax regulation amendments which update and revise the existing regulations concerning manufacturers excise tax on tires, tubes and tread rubber.

DATE: Except as otherwise provided in this document, the amendments are effective March 12, 1982. However, the fact that the regulations in this document are prospective does not preclude the application of prior Internal Revenue Service positions to periods prior to the effective date of the regulations.

FOR FURTHER INFORMATION CONTACT: John A. Tolleris of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Ave., N.W., Washington, D.C. 20224, Attention: CC:LR:T (202-566-3294).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On December 4, 1980, the FEDERAL REGISTER published proposed amendments to the Manufacturers and Retailers Excise Tax Regulations [26 CFR Part 48] under sections 4071 through 4073 of the Internal Revenue Code of 1954 (45 FR 80309). These amendments were proposed to conform the regulations to certain provisions under section [1](a) of the Act of August 1, 1966, Pub. L. 89-523, 80 Stat. 331 [1966-2 C.B. 599]; section 401(f) of the Revenue Act of 1971, 85 Stat. 533 [Pub. L. 92-178, 1972-1 C.B. 443, 465]; section 502(a)(4) of the Highway Revenue Act of 1978, 92 Stat. 2756 [Pub. L. 95-599, 1978-2 C.B. 403]; and section 108(c)(2)(C) of the Technical Corrections Act of 1979, 94 Stat. 227 [Pub. L. 96-222, 1980-1 C.B. 499, 516]. After consideration of comments received in response to the notice of proposed rulemaking, those amendments are adopted as modified by this Treasury decision. In addition, this Treasury decision conforms the regulations to section 4(a) of the Act of December 24, 1980, Pub. L. 96-596, 94 Stat. 3475 [1980-2 C.B. 653, 656].

EXPLANATION OF PROVISIONS

The final regulations update and revise the existing regulations regarding manufacturers excise tax on tires, tubes and tread rubber. These amendments supersede and delete §§48.4071-1 through 48.4073-4 of the Manufacturers and Retailers Excise Tax Regulations, §142.3-1 of the Temporary Excise Tax Regulations under the Revenue Act of 1971, and Part 144 of the Temporary Excise Tax Regulations Relating to Tax on Tires and Tubes Delivered to Manufacturer's Retail Outlet.

The final regulations include provisions concerning the imposition and rates of the excise tax on tires, the imposition of tax on tires and tubes delivered to the manufacturer's retail outlet, the imposition of tax upon original equipment tires on imported articles, exemptions for certain tires, and definitions of terms such as "tires of the type used on highway vehicles" and "manufacturers."

Section 48.4071-1(b) revises the current provisions regarding the rates at which excise tax is imposed upon tires, inner tubes, and tread rubber to reflect modifications made in Code section 4071 by section 4(a) of the Act of December 24, 1980, Public Law 96-596.

Section 48.4071-3 incorporates, with minor revisions, and supersedes those rules now contained in §144.1-1 of the Temporary Excise Tax Regulations Relating to Tax on Tires and Tubes Delivered to Manufacturer's Retail Outlet.

Section 48.4071-4 incorporates, with minor revisions, and supersedes those rules now contained in §142.3-1 of the Temporary Excise Tax Regulations under the Revenue Act of 1971.

Several comments were received in response to the notice of proposed rulemaking published in the Federal Register for December 4, 1980. One commentator recommended that §48.4071-2(a) regarding determination of the weight of tires and inner tubes be amended to provide that manufacturers who do not use the alternative method of determining weight allowed by §48.4071-2(b) must use the actual weight of each tire and inner tube in computing their excise tax liability under section 4071. This suggestion was not followed because although only one alternative method of weighing has thus far been permitted by the Commissioner, this does not mean that other alternative methods may not be approved by the Commissioner in the future.

Two commentators expressed concern that inclusion within the definition of taxable tread rubber of "a continuous rubber ribbon produced through an extrusion process for direct application in recapping or retreading a tire casing" could require rubber strip, slabs, or pellet used as raw material for the extrusion process to be taxed as "tread rubber." In response to their requests for clarification, §48.4072-1(b) has been revised to provide that the term "tread rubber" does not include rubber in various forms used as raw material for the extrusion process.

Evaluation of the effectiveness of these regulations will be based on comments received from offices within the Treasury and the Internal Revenue Service, other governmental agencies, and the public. These regulations will impose no additional reporting or recordkeeping requirements.

DRAFTING INFORMATION

The principal author of this regulation is John A. Tolleris of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Amendments To The Regulations

The amendments to 26 CFR Part 48, 26 CFR Part 142, and 26 CFR Part 144 are as follows:

PART 142—TEMPORARY EXCISE TAX REGULATIONS UNDER THE REVENUE ACT OF 1971

§142.3-1 [Removed]

Paragraph 1. Section 142.3-1 is removed.

PART 144—TEMPORARY EXCISE TAX REGULATIONS RELATING TO TAX ON TIRES AND TUBES DELIVERED TO MANUFACTURER'S RETAIL OUTLET [Removed]

Par. 2. Part 144 is removed.

PART 48—MANUFACTURERS AND RETAILERS EXCISE TAXES

Par. 3. Sections 48.4071-1, 48.4071-2, 48.4072-1, and 48.4073-1 through 48.4073-4 are revised and 48.4071-3 and 48.4071-4 are added to read as follows:

Tires, Tubes, and Tread Rubber

§48.4071-1 Imposition and rates of tax.

(a) *Imposition of tax.* Section 4071 imposes a tax upon the following articles sold by the manufacturer thereof:

(1) Tires made wholly or in part of rubber;

(2) Inner tubes (for tires) made wholly or in part of rubber, and

(3) Tread rubber.

For definitions of the terms "tires," "inner tubes," "tread rubber," "rubber," and "manufacturer," see §48.4072-1.

(b) *Rates and computation of tax—(1) Rates of tax.* Tax is imposed upon each of the above-mentioned taxable articles at the rate applicable on the date on which the article is sold, as specified below:

	Cents per pound
(i) *Tires:*	
(A) Of the type used on highway vehicles:	
(*1*) For the period July 1, 1965, to December 31, 1980, inclusive	10
(*2*) For the period January 1, 1981, to September 30, 1984 inclusive	9.75
(*3*) On or after October 1, 1984	4.875
(B) Of the type used on other than highway vehicles:	
(*1*) For the period July 1, 1965, to December 31, 1980, inclusive	5
(*2*) On or after January 1, 1981	4.875
(C) Laminated tires. On or after July 1, 1965	1
(ii) *Inner Tubes:*	
(A) For the period July 1, 1965, to September 30, 1984, Inclusive	10
(B) On or after October 1, 1984	9
(iii) *Tread rubber:* For the period July 1, 1965, to September 30, 1984, inclusive	5

(2) *Computation of tax.* The tax on tires, inner tubes, and tread rubber is computed by applying to the total weight (including a fractional part of a pound) of the article the rate in effect at the time the article is sold. See §48.4071-2, relating to determination of weight.

(c) *Liability for tax.* The tax imposed by section 4071 is payable by the manufacturer when the manufacturer makes a sale of a taxable article, or as provided in section 4071(b) and §48.4071-3 for a manufacturer who sells at retail, when the manufacturer delivers a taxable article to a retail store, or to a retail outlet, of the manufacturer.

(d) *Recapped or retreaded tires.* The recapping or retreading of a tire (other than from bead to bead) does not constitute manufacture of a taxable article. The tax imposed by section 4071 does not apply to the sale of a tire so recapped or retreaded, if before such sale there had been a sale of the tire in the United States and the tire was a taxable tire at the time of such previous sale in the United States as distinguished from a carcass that has lost its utility as a tire. The recapping or retreading of a tire from bead to bead (whether or not the original tire is a carcass that had lost its utility as a tire) does constitute manufacture of a taxable tire. The tax imposed by section 4071 applies to the sale or use of a tire that has been so recapped or retreaded.

§48.4071-2 Determination of weight.

(a) *In general*—(1) *Tires.* (i) Metal rims or rim bases are not to be included in determining the total weight of a tire. However, the wire, staples, darts, clips, and other material or fastening devices which form a part of the tire or are required for its use must be included in determining the total weight of the tire. Studs are considered to be part of a tire and are to be included when determining the weight of a tire. In the case of a tubeless tire, the total weight includes the weight of the air valve and stem or any other mechanism that functions as a part of the tire and is used in connection with inflating the tire or maintaining its air pressure.

(ii) When tires are sold with metal rims or rim bases attached, the manufacturer must maintain records that will establish what portion of the total weight of the finished product represents the tire exclusive of the metal rim or rim base.

(2) *Inner tubes.* The total weight of an inner tube includes the weight of the air valve and stem or any other mechanism attached to the inner tube that is used in connection with inflating the tube or maintaining its air pressure.

(b) *Alternative method of determining weight of tires and inner tubes.* A manufacturer who has received permission from the Commissioner may, subject to such conditions as the Commissioner may prescribe, determine total weight of tires and inner tubes manufactured and sold by the manufacturer on the basis of the average weight for each type, size, grade, and classification shown in schedules published by the tire industry. The average weights must be established in accordance with the method approved by the Commissioner and apply for such periods as the Commissioner may prescribe. The Commissioner may terminate the approval granted any manufacturer. In the case of the termination of the approval granted any manufacturer, the termination becomes effective 10 days from the date of the receipt by the manufacturer of the notice of termination. A manufacturer may effect termination, as of a specified date, of the privilege to determine total weight in accordance with provisions of this paragraph by giving no less than 10 days written notice of such intention to the Commissioner. The termination of the approval given a manufacturer does not affect a manufacturer's tax liability for tires and inner tubes sold prior to the effective date of the notice of termination.

§48.4071-3 Imposition of tax on tires and tubes delivered to manufacturer's retail outlet.

(a) *General rule.* If, on or after October 1, 1966, a tire or inner tube is delivered by the manufacturer thereof to a retail outlet of the manufacturer, the manufacturer is liable for tax in respect of the tire or tube at the rate set forth in section 4071 in the same manner as if the tire or tube had been sold at the time it was delivered to the retail outlet. The amount of tax payable shall be computed in accordance with the provisions of paragraph (b)(2) of §48.4071-1, and of §48.4071-2.

(b) *Definition of retail outlet.* For purposes of this section, the term "retail outlet" includes the term "retail store." A retail outlet is a facility maintained by a manufacturer for selling tires or tubes at retail. A facility may be a retail outlet even though some sales are made at wholesale at such facility; see paragraph (d)(1) of this section. A facility may also be considered to a retail outlet for the purposes of this section notwithstanding that its main activity is in another area than selling tires or inner tubes. For example, if a manufacturer operates a facility for both automotive repair and the selling of tires at retail, the facility is considered a retail outlet for the purposes of this section even if the primary activity of the facility is automotive repair. No facility is considered a retail outlet for the purposes of this section if it is determined that less than 15 percent of the taxable tires and inner tubes removed from such facility are sold at retail by such facility. The determination described in the preceding sentence is made on the basis of the experience of a representative period, of at least 12 consecutive calendar months during the 2-year period immediately preceding the first day included in the return period for which tax under section 4071(b) is reported. If a facility has not been in existence during such a 12-month period, the determination is made on the basis of the available experience of the manufacturer. See also paragraph (c)(3) of this section, relating to imposition of tax where a retail outlet is maintained as an adjunct to a production facility or distribution center.

(c) *Delivery*—(1) *In general.* A manufacturer of tires or inner tubes may, at its option, treat either of the following events as constituting delivery to a retail outlet:

(i) Delivery of tires or inner tubes to a common carrier (or, where the tires or tubes are transported by the manufacturer, the placing of the tires or tubes into the manufacturer's over-the-road vehicle) for shipment from the plant in which the tires or tubes are manufactured, or from a regional distribution center of tires and inner tubes, to a retail outlet or to a location in the immediate vicinity of a retail outlet primarily for future delivery to the retail outlet.

(ii) Arrival of the tires or tubes at the retail outlet, or, where shipment is to a location in the immediate vicinity of a retail outlet primarily for future delivery to the retail outlet, the arrival of the tires or tubes at such location.

In its excise tax return for the first return period beginning after September 30, 1966, a manufacturer of tires or inner tubes must elect to determine the date of delivery to retail outlets in accordance with one of the two subdivisions of this paragraph (c)(1) and must determine the dates of all deliveries made to all retail outlets in accordance with the subdivision which the manufacturer has elected to apply. The election may be made in a statement attached to the return for such period. Having elected to treat one of the events listed in subdivision (i) or (ii) of this paragraph (c)(1) as constituting delivery to a retail outlet for purposes of its return for the first return period after September 30, 1966, the manufacturer may not use a different criterion for a subsequent return period unless permission of the district director is obtained in advance.

(2) *Deliveries made in the immediate vicinity of a retail outlet primarily for future delivery to the retail outlet.* (i) For purposes of this section, any delivery which is made in the immediate vicinity of a retail outlet primarily for future delivery to the retail outlet is deemed to be a delivery to the retail outlet. For the purpose of the preceding sentence, a location is considered to be in the immediate vicinity of a retail outlet if the distance between the location and the retail outlet is sufficiently small so that it is feasible to transport tires and inner tubes between the location and the retail outlet by means of dollies, fork lift trucks, pushcarts, and similar vehicles of the type normally used around the premises of factories and similar establish-

ments, as opposed to highway motor vehicles. For the purpose of the preceding sentence, it is immaterial that a public thoroughfare must be used in order to transport tires or inner tubes to a retail outlet from another location. Tires and inner tubes delivered to a location in the immediate vicinity of a retail outlet are considered to be delivered to the location "primarily for future delivery" to the retail outlet if it is determined that a majority (by number) of the tires and tubes removed from the location are delivered to the retail outlet. The determination described in the preceding sentence is made on the basis of the experience of a representative period of at least 12 consecutive calendar months during the 2-year period immediately preceding the first day included in the return period for which tax under section 4071(b) is reported. If a facility has not been in existence during such a 12-month period, the determination is made on the basis of the available experience of the manufacturer. If it is determined that the majority of all tires and inner tubes removed from a given location are delivered to a retail outlet of the manufacturer in the immediate vicinity of the location, tax is imposed upon all tires and tubes delivered by the manufacturer to the location, even though all or part of the tires or tubes comprising a particular shipment to the location may be intended for further transportation to a location other than the retail outlet. If it is determined that a majority of all tires and inner tubes removed from a given location are not delivered to a retail outlet of the manufacturer in the immediate vicinity of the location, tax is imposed upon the removal of a tire or inner tube from the location to the premises of the retail outlet. See also paragraph (d)(2) of this section, relating to sales by the manufacturer at facilities other than retail outlets.

(ii) The provisions of this paragraph (c)(2) may be illustrated by the following examples.

Example. A manufacturer of tires and tubes whose plant is located in City X operates two facilities in City Y; Warehouse A and Store Q. Store Q is a retail outlet within the meaning of paragraph (b) of this section, and Warehouse A is in the immediate vicinity of Store Q. During the 12-month period ending September 30, 1966, 60 percent of the tires and inner tubes removed from Warehouse A were delivered to Store Q. All tires or inner tubes delivered by the manufacturer to Warehouse A are subject to a tax under section 4071(b) and this section (unless, before such delivery, tax was imposed on the same tires and tubes).

(3) *Retail outlet maintained as adjunct of production or distribution facility.* If a retail outlet is maintained as an adjunct to and in the immediate vicinity of a facility which is not a retail outlet (as, for example, a production plant or a regional distribution center), delivery to the retail outlet is deemed to occur at the earlier of—

(i) The date when a tire or inner tube is removed from the general storage facilities in the facility which is not a retail outlet for transfer to the premises of the retail outlet, or

(ii) The date when a tire or inner tube is designated to be sold by or at the retail outlet.

(d) *Special rules*—(1) *Retail outlets which also sell at wholesale.* Tax applies to all shipments of tires and inner tubes delivered to a retail outlet as defined in paragraph (b)(2) of this section. Thus, for the purposes of section 4071(b) and this section, it is immaterial that all or part of the tires or inner tubes of a particular delivery to a retail outlet are intended for sale at wholesale. See also paragraph (d)(3) of this section.

(2) *Sales by manufacturer at facilities other than retail outlets.* Sales by the manufacturer of tires and inner tubes at facilities other than retail outlets are subject to tax under section 4071(a).

(3) *Deliveries of tires or tubes on which tax has been previously imposed.* (1) Tax is not imposed under section 4071(b) and this section on any tire or inner tube in respect of which there was previously imposed a tax under section 4071(a). Similarly, a tire or inner tube is taxed only once under section 4071(b) and this section.

(ii) The provisions of this paragraph (d)(3) may be illustrated by the following example:

Example. A manufacturer has two selling facilities, Store No. 1 and Store No. 2. Only retail sales are made at Store No. 2, which obtains its merchandise from Store No. 1. Assume that, although wholesaling and distribution activities are conducted at Store No. 1, the sale of tires and tubes at retail is conducted at Store No. 1 to the extent that Store No. 1 is a retail outlet within the meaning of paragraph (b) of this section, with the result that tax is imposed on deliveries by the manufacturer of tires and tubes to Store No. 1. Tax is not imposed on a delivery of tires or inner tubes from Store No. 1 to Store No. 2.

§48.4071-4 Original equipment tires on imported articles.

The tax imposed by section 4071(a) applies with respect to tires and inner tubes (other than bicycle tires and inner tubes) that are original equipment for an imported article upon which no tax is imposed under section 4061 if the article is sold on or after December 11, 1971. In such a case, the importer of the article is treated as the manufacturer and vendor of the tires and inner tubes with which the article is equipped. However, the tax imposed by section 4071(a) is not imposed with respect to tires and inner tubes if the imported article is an automobile bus chassis or an automobile bus body. Solely for purposes of this section, the provisions of section 4218 (relating to use by a manufacturer or importer considered a sale) do not apply in cases where an individual imports an article having original equipment tires and tubes and on which article no tax is imposed under section 4061 if the article is imported solely for the individual's personal use and is so used.

§48.4072-1 Definitions.

For purposes of the regulations in this part, unless otherwise expressly indicated:

(a) *Rubber.* The term "rubber" includes synthetic and substitute rubber.

(b) *Tread rubber.* The term "tread rubber" means any material (1) which is commonly or commercially known as tread rubber or camelback, or (2) which is a substitute for any material commonly or commercially known as tread rubber or camelback and is of a type used in recapping or retreading tires. The term includes, for example, strips of material, wholly or partially of rubber, natural or synthetic, intended to be vulcanized or otherwise affixed to a tire casing to form the outside perimeter of the tire, smooth or treaded. It also includes treading material produced by reprocessing scrap, salvage, or junk rubber and a continuous rubber ribbon produced through an extrusion process for direct application in recapping or retreading a tire casing. The term does not include rubber in various forms such as strip, slab, pellet, etc. which is used as raw material for the extrusion process. Tread rubber loses its identity as such when it has been used in the recapping or retreading of a tire of a type used on a highway vehicle (without regard to the actual use ultimately made of the tire) or has deteriorated in quality to the point where it is no longer suitable for use in recapping or retreading of a tire. (In the case of such deterioration, see section 6416(b)(2) and §48.6416 (b)-2 to secure a refund or credit of the tax paid.)

(c) *Tires of the type used on highway vehicles.* (1) The term "tires of the type used on highway vehicles", for purposes of §§48.4071-1 through 48.4073-3 means tires of the type used on—

(i) Motor vehicles that are highway vehicles (within the meaning of §48.4061(a)-1(d)), or

(ii) Vehicles of the type used in connection with motor vehicles that are highway vehicles (within the meaning of §48.4061(a)-1(d)).

The term "tires of the type used on highway vehicles" does not include bicycle tires. Bicycle tires, however, are included in the term "other tires" as used in section 4071(a)(2).

(2) For purposes of paragraph (c)(1)(i) of this section, tires of the type used on motor vehicles that are highway vehicles include tires used on motor trucks, buses, passenger automobiles, motor homes, highway tractors, trolley buses or coaches, and motorcycles.

(3) For purposes of paragraph (c)(1)(ii) of this section, tires of the type used on vehicles of the type used in connection with motor vehicles that are highway vehicles include tires used on truck or bus trailers, truck semitrailers, mobile homes, housetrailers, or utility trailers.

(d) *Inner tubes.* The term "inner tubes" includes air containers of all types made wholly or in part of rubber and designed and manufactured for use in pneumatic tires.

(e) *Tires.* The term "tires" includes rubber casings, hoops, and strips or bands of all kinds designed and shaped or built to form the tread of or to fit a vehicle wheel. Tires of either the pneumatic or solid type which fit or form the tread for wheels of any article which is capable of use as a means of transporting a person or burden are taxable as tires. Examples of articles which may be equipped with taxable tires are motor scooters, minibikes, industrial trucks, farm tractors, wheelbarrows, and similar articles. See section 4073(a) and §48.4073-1 with respect to the exemption of tires of certain sizes, and section 4073(b) and §48.4073-2 with respect to the exemption for tires with internal wire fastening.

(f) *Laminated tires.* For purposes of the tax imposed by section 4071, the term "laminated tires" means tires (1) which are not "tires of the type used on highway vehicles" within the meaning of paragraph (c) of this section, and (2) which consist wholly of scrap rubber from used tire casings with an internal metal fastening agent.

(g) *Manufacturer.* The term "manufacturer" means manufacturer, producer, or importer. A person who converts, by any process, a new tire taxable under section 4071 at one rate of tax into a tire taxable under section 4071 at a different rate (as for example, an off highway-type tire converted into a highway-type tire) is considered to be a manufacturer of the converted tire. If a conversion results in a reduced rate of tax for the converted tire, see section 6416(b)(2) and §48.6416(b)-2 to secure a credit or refund of part of the tax paid. The term "manufactured" includes "produced" and "imported".

(h) *Cross references.* For other definitions, see §48.0-2.

§48.4073-1 Exemption of tires of certain sizes.

The tax does not apply to sales of tires of all-rubber construction (whether hollow center or solid) if they have no fabric or metal reinforcement and do not exceed either of these measurements: (a) 20 inches in diameter measured to the outside circumferences, and (b) 1¾ inches in cross-section. The exemption provided by section 4073(a) is to be determined solely on the measurements of the tire and not on the purpose for which it is designed or used.

§48.4073-2 Exemption of tires with internal wire fastening.

The tax does not apply to sales of tires of any size or dimension manufactured from extruded tiring that is fastened or held together by means of internal wire or other metallic material.

§48.4073-3 Exemption of tread rubber used for recapping nonhighway tires.

(a) *Sold direct by manufacturer for nontaxable use.* The tax does not apply to the sale of tread rubber by the manufacturer to any person for use by that person otherwise than in the recapping or retreading of tires of the type used on highway vehicles. In determining whether tread rubber is sold for a taxable or nontaxable use, the type of vehicle on which the recapped or retreaded tire is to be used, or the actual or intended use of the recapped or retreaded tire, is immaterial. The controlling factor is whether the tire resulting from the recapping or retreading is of a type that is used otherwise than on a highway vehicle. For definition of "tires of the type used on highway vehicles", see paragraph (c) of §48.4072-1.

(b) *Sales for resale for nontaxable use.* No sale of tread rubber may be made tax free for resale even though it is known at the time of the sale that the tread rubber will be resold for use otherwise than in the recapping or retreading of tires of the type used on highway vehicles. However, where the tread rubber is resold for such use, the manufacturer who paid the tax on a sale of the tread rubber may secure a refund or credit in accordance with the provisions of section 6416(b)(2) and §48.6416(b)-2.

(c) *Evidence required to establish exemption.* (1) To establish the right to sell tread rubber tax free under section 4073(c), the manufacturer must obtain from the purchaser and retain in its possession a properly executed exemption certificate.

(2) Where only occasional sales of tread rubber for exempt use are made to a purchaser, a separate exemption certificate should be furnished for each order. However, where sales are regularly and frequently made to a purchaser for exempt use, a certificate covering all purchases during the period not to exceed 12 calendar quarters is acceptable. The certificates and proper records of invoices, orders, etc., relative to tax-free sales must be kept for inspection by the district director as provided in section 6001 and the regulations in Subpart Q.

(d) *Acceptable form of exemption certificate.* The following form of exemption certificate is acceptable for the purposes of this section and must be adhered to in substance:

Exemption Certificate

(For use by persons who purchase tread rubber from the manufacturer, producer, or importer thereof for use otherwise than in recapping or retreading tires of the type used on highway vehicles (section 4073(c) of the Internal Revenue Code).)

(Date) ____________, 19____

I, the undersigned, certify that I am the purchaser, or the (Title) ____________ of (Name of purchaser if other than the undersigned) ____________ who is the purchaser of: ____________ The tread rubber specified in the accompanying order or contract, or ____________ All tread rubber specified in contracts or orders entered into or placed with (Name of seller) ____________ for the period commencing ____________ and ending ____________ (period not to exceed 12 calendar quarters), and that such tread rubber will not be used in the recapping or retreading of tires of the type used on highway vehicles, but will be used for the following purposes:

____

____

____

The undersigned understands that if the tread rubber is used for the recapping or retreading of tires of the type used on highway vehicles, or is sold or otherwise disposed of, such fact must be promptly reported to the manufacturer. The undersigned also understands that the fraudulent use of this certificate for the purpose of securing this exemption will subject the undersigned or any other party making such fraudulent use to a fine of not more than $10,000, or to imprisonment for not more than 5 years, or both, together with costs of prosecution. The purchaser also understands that the purchaser must be prepared to establish by satisfactory evidence the purpose for which the tread rubber was used.

(Signature) ________________________

(Address) ________________________

(e) *Exemption certificate not obtained prior to filing of manufacturer's excise tax return.* If the sale is otherwise exempt but the exemption certificate is not obtained prior to the time the manufacturer files a return covering taxes due for the period during which the sale was made, the manufacturer must include the tax on the sale in its return for that period. However, if the certificate is later obtained, a claim for refund of the tax paid on the sale may be filed, or a credit for the amount may be taken upon a subsequent return, as provided by section 6416(b)(2) and §48.6416(b)-2.

§48.4073-4 Other tax-free sales.

(a) *Cross references.* For provisions relating to tax-free sales of articles referred to in section 4071, see:

(1) Section 4221, relating to certain tax-free sales, and the regulations thereunder in Subpart H;

(2) Section 4222, relating to registration, and the regulations thereunder in Subpart H;

(3) Section 4223, relating to special rules pertaining to further manufacture, and the regulations thereunder in Subpart H; and

(4) 28 FR 348, January 12, 1963, relating to the authorization of an exemption from the tax imposed by section 4071 by the Secretary of the Treasury under section 4293 for sales of certain tires and inner tubes sold to the American Red Cross on or after March 1, 1963.

This Treasury decision is issued under the authority contained in sections 4071(b), 4071(c), 4073(c), and 7805 of the Internal Revenue Code of 1954. [80 Stat. 331, 26 U.S.C. 4071(b); 68A Stat. 482, 26 U.S.C. 4071(c); 70 Stat. 389, 26 U.S.C. 4073(c); 68A Stat. 917, 26 U.S.C. 7805].

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved February 2, 1982.

JOHN E. CHAPOTON,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on February 9, 1982, 8:45 a.m., and published in the issue of the Federal Register for February 10, 1982, 47 F.R. 6004.)

---

26 CFR 48.4071-2: Determination of weight.

Amplification of Rev. Proc. 80-19, which provides a method for determining the average weight of tires and inner tubes for manufacturers excise tax purposes. See Rev. Proc. 82-17, page 462.

Part III.—Petroleum Products
Subpart A.—Gasoline

Section 4081.—Imposition of Tax

26 CFR 48.4081-1: Imposition and rates of tax.

A credit or refund of manufacturers excise tax is not available to a wholesale distributor who purchased tax-paid gasoline and resold it without passing on the amount of tax. See Rev. Rul. 82-53, page 210.

Section 4083.—Exemption of Sales to Producer

26 CFR 48.4083-1: Exemption; sales to producers of gasoline.

A credit or refund of manufacturers excise tax is not available to a wholesale distributor who purchased tax-paid gasoline and resold it without passing on the amount of tax. See Rev. Rul. 82-53, page 210.

Subpart B.—Lubricating Oil

Section 4091.—Imposition of Tax

26 CFR 48.4091-1: Tax on lubricating oils.

Whether the payment provided by section 6424 of the Code is available to the ultimate purchaser of lubricating oil that is used in a highway vehicle in its trade or business. See Rev. Rul. 82-77, page 211.

Subchapter D.—Recreational Equipment
Part I.—Sporting Goods

Section 4161.—Imposition of Tax

26 CFR 48.4161(a)-1: Imposition and rate of tax; fishing equipment.
(Also Section 4216; 48.4216(b)-1.)

Fishing rods and reels; imported; sales price. A domestic trading corporation imports fishing rods and reels that it sells exclusively to a domestic distributing company that is owned by the foreign manufacturer of the fishing equipment, the trading company, and the trading company's foreign parent corporation. Because the trading company provides all credit and financing, incurs the risk of loss, and promotes the sale of the equipment, it is considered the importer for purposes of the excise tax on the fishing equipment.

Section 4161

Rev. Rul. 82-40

ISSUE

1. For purposes of the manufacturers excise tax imposed by section 4161(a) of the Internal Revenue Code, who is the importer of taxable rods and reels in the situation described below?

2. What basis is used for computing excise tax on the importer's sale of rods and reels?

FACTS

X is a foreign corporation that manufactures various fishing equipment. *P*, also a foreign corporation, unrelated to *X*, is a trading company engaged in the export business. In addition to other products, *P* exports fishing rods and reels manufactured by *X*. *P* is the exclusive exporter of *X*'s products.

In an attempt to improve the market for its products in the United States, *X* approached *S*, a domestic subsidiary of *P* engaged in international trade, to explore various marketing arrangements. An arrangement was made under which *S* acts as the importer of *X*'s products in the United States and sells them to *Y*, a corporation created to act as the domestic wholesale distributor of *X*'s fishing equipment. Under the agreement, *Y* is the exclusive distributor of *X*'s fishing equipment in the United States. *Y* is owned 70% by *X*, 15% by *P*, and 15% by *S*.

When *Y* places an order with *S*, *S* has the right to accept or reject the order and to limit the quantity ordered. *S* maintains no inventory of fishing equipment and imports rods and reels only as they are needed by *Y*. The price of the goods to *Y* is determined at the time an order is accepted, and the risk of any fluctuation in price or importation cost is borne by *S*. In addition, *S* assumes any risk for defective merchandise delivered to *Y* and must seek restitution from its supplier, *P*.

Title to the fishing equipment passes to *Y* at the port of entry after it has cleared customs. *Y* is required by the agreement to pay *S* for the merchandise within 120 days of the issuance of the bill of lading. The entire cost of importation, including credit arrangements, is borne by *S*. *S* receives no direct or indirect financial assistance from *X*, *P*, or *Y*.

The agreement requires *Y* to promote *X*'s merchandise in the United States. However, *S* also actively promotes its own goods, including goods imported for *Y*, at trade shows, especially new articles that *S* discusses with *Y*'s actual and potential customers in order to create a market for those articles in this country.

LAW AND ANALYSIS

Section 4161(a) of the Code imposes a tax of 10 percent of the sales price on the sale by the manufacturer, producer, or importer of fishing rods, reels, creels, and artificial lures, baits, and flies.

Section 48.0-2(a)(4)(i) of the Manufacturers and Retailers Excise Tax Regulations defines an "importer" of taxable articles as any person who brings such an article into the United States from any source outside the United States.

Rev. Rul. 68-197, 1968-1 C.B. 455, states that an importer is the person who as principal and not as agent arranges for, or is the inducing and efficient cause of, goods being brought into the United States for purposes of use or sale by that person. The passing of title to the goods, either at the time of shipment or upon arrival in this country, is not a controlling factor.

In *Import Wholesalers Corporation v. United States*, 368 F.2d 577 (Ct. Cl. 1966), the plaintiff, an automobile dealer, was held to be the importer when another party placed the order with the foreign supplier and was named as importer in all of the documents, but plaintiff provided all of the financing to make importation possible and paid the other party a competitive market price plus $5 for each automobile. The court determined that the technicalities of importation were outweighed by the financing arrangements and that the small fee paid by the plaintiff was adequate payment for the risks and responsibilities assumed by the other party.

In *Sony Corporation of America v. United States*, 428 F.2d 1258 (Ct. Cl. 1970), the court determined that the sales agent, not the distributor (Sony), was the importer. In doing so, the court looked to the foreign manufacturer's reliance on the sales agent's knowledge of the market, the agent's promotional activities and efforts in introducing new products, the risk of loss borne by the agent, and the inclusion of the agent in the chain of title.

In *Corex Corporation v. United States*, 524 F.2d 1017 (9th Cir. 1975), *cert denied*, 425 U.S. 912 (1976), the court of appeals reversed the district court finding that Jon H., an association that performed importation functions for Corex Corp., rather than Corex Corp., was the importer of fishing reels and supplies. Applying the rules of *Sony* and *Import Wholesalers* to the facts of the case, the court concluded Jon H. was not the importer because Jon H. performed no substantial promotional activities, bore none of the usual risks, performed no function other than as a conduit, and earned little profit.

In the present situation, *S* is an established importer of many types of articles. *S* was instrumental in the creation of *Y* to act as a distributor of *X*'s products. *S* provides all the credit and financing for the imported goods, and it finances *Y*'s purchase for up to 120 days after issuance of the bill of lading. *S* incurs the risk of price changes after acceptance of *Y*'s order. *S* also actively promotes the sale of both new and existing imported articles. These factors indicate that *S* is the inducing and efficient cause of the importation of the fishing equipment.

Generally, the basis for computing the manufacturers excise tax is the actual selling price of the article. If, however, an article is sold, otherwise than through an arm's length transaction at less than a fair market price, the tax must be based on a constructive sale price determined under section 4216(b) of the Code. Section 48.4216(b)-2(e) of the regulations states that a sale is considered to be otherwise than at arm's length if (1) one of the parties is controlled (in law or in fact) by the other, or there is common control, whether or not such control is actually exercised to influence the sale price, or (2) the sale is made under special arrangements between a manufacturer and a purchaser.

S and *P* are minority stockholders in *Y*. Their interests, however, are not large enough either singly or jointly to constitute control of *Y*. *X*, the majority stockholder in *Y*, is not related to, controlled by, or in control of either *P* or *S*. Nor are there any factors present that indicate the sales are made under a special arrangement. A special arrangement exists when there are factors other than control that indicate there is no adverse economic interest between the parties to a transaction. A lack of adverse economic interest does not necessarily exist because all parties to a transaction may benefit in some way, for example, having an assured market or source of supply or earning a profit.

HOLDING

1. *S* is the importer of rods and reels in this situation and is liable for tax on its sale of taxable rods and reels to *Y*.

2. The tax on *S*'s sale to *Y* is to be based on the actual price for which the rods and reels are sold.

Subchapter F.—Special Provisions Applicable to Manufacturers Tax

Section 4216.—Definition of Price

26 CFR 48.4216(b)-1: Constructive sale price; scope and application.

Basis used for computing excise tax on the importer's sale of rods and reels. See Rev. Rul. 82-40, page 175.

Section 4217.—Leases

26 CFR 48.4217-2: Limitation on amount of tax applicable to certain leases.

Application of tax on a manufacturer's sale to a dealer of trucks that when new had been leased to a United States agency for use in a foreign country. See Rev. Rul. 82-7, page 167.

Subchapter G.—Exemptions, Registrations, etc.

Section 4221.—Certain Tax-Free Sales

26 CFR 48.4221-2: Tax-free sale of articles to be used for, or resold for, further manufacture.

Who may properly claim a credit or refund of tax paid on the sale of an automotive part or accessory used in the manufacture of another article? See Rev. Rul. 82-14, page 210.

26 CFR 48.4221-3: Tax-free sale of articles for export, or for resale by the purchaser to a second purchaser for export.

Application of tax on a manufacturer's sale to a dealer of a truck that when new had been leased to a United States agency for use in a foreign country. See Rev. Rul. 82-7, page 167.

26 CFR 48.4221-5: Tax-free sale of articles to States and local governments for their exclusive use.

Whether a nonprofit community action organization comes within the scope of the federal excise tax exemptions for states and local governments. See Rev. Rul. 82-30, page 165.

26 CFR 48.4221-5: Tax-free sale of articles to States and local governments for their exclusive use.

Whether sales to a nonprofit parent-teacher association come within the scope of the federal excise tax exemptions for states and local governments. See Rev. Rul. 82-31, page 166.

Chapter 33.—Facilities and Services
Subchapter B.—Communications

Section 4253.—Exemptions

Whether a nonprofit community action organization comes within the scope of the federal excise tax exemptions for states and local governments. See Rev. Rul. 82-30, page 165.

Whether a nonprofit parent-teacher association comes within the scope of the federal excise tax exemptions for states and local governments. See Rev. Rul. 82-31, page 166.

Chapter 36.—Certain Other Excise Taxes
Subchapter D.—Tax on Use of Certain Vehicles

Section 4481.—Imposition of Tax

26 CFR 41.4481-1: Imposition of tax.

Claims for refund of the highway use tax paid for periods prior to July 1, 1981, by Canadian truckers described in Rev. Rul. 81-86, 1981-1 C.B. 504. See Rev. Rul. 82-126, page 204.

Section 4483.—Exemptions

Whether a nonprofit community action organization comes within the scope of the federal excise tax exemptions for states and local governments. See Rev. Rul. 82-30, page 165.

26 CFR 41.4483-1: State and local governmental exemption.

Whether a nonprofit parent-teachers association comes within the scope of the federal excise tax exemptions for states and local governments. See Rev. Rul. 82-31, page 166.

Chapter 43.—Qualified Pension, etc., Plans

Section 4975.—Tax on Prohibited Transactions

Prohibited Transaction Exemption 81-82

Class Exemption for Guaranteed Contract Separate Accounts

AGENCY: Office of Pension and Welfare Benefit Programs, Labor.

ACTION: Grant of Class Exemption.

SUMMARY: This document contains a final class exemption for certain transactions involving separate accounts maintained by life insurance companies in connection with contracts under which the life insurance company either: (1) guarantees repayment of amounts deposited with it by an employee pension benefit plan, together with accrued interest, on a fixed date, or (2) guarantees payment of a fixed annuity. In the absence of the exemption, these transactions might be prohibited by sections 406(a) and 407 of the Employee Retirement Income Security Act of 1974 [Pub. L. 93-406, 1974-3 C.B. 1.] (ERISA, or the Act) and might result in the imposition of taxes under sections 4975(a) and (b) of the Internal Revenue Code of 1954 (the Code) with respect to certain transactions described in sections 4975(c)(1)(A) through (D) of the Code.[1] The class exemption will affect life insurance companies, employee pension benefit plans, participants and beneficiaries of such plans, and parties in interest and fiduciaries with respect to such plans.

---

[1] As discussed below, the Department is publishing elsewhere in this issue of the FEDERAL REGISTER a proposed class exemption that would provide relief from the restrictions of 406(b) of ERISA, as well as relief from the taxes imposed by sections 4975(a) and (b) of the Code by reason of sections 4975(c)(1)(E) and (F) thereof, for certain transactions involving separate accounts of the kind described above.

DATE: The exemption is effective January 1, 1975.

FOR FURTHER INFORMATION CONTACT: William A. Schmidt, Plan Benefits Security Division, Office of the Solicitor, U.S. Department of Labor, Washington, D.C., 20216. Telephone (202) 523-9592. This is not a toll-free number.

SUPPLEMENTARY INFORMATION: On August 1, 1980, (45 FR 51303) the Department of Labor (the Department) published a notice of the pendency before it of a proposed class exemption from the restrictions of sections 406 and 407 of ERISA and the taxes imposed by sections 4975(a) and (b) of the code for certain transactions involving insurance company separate accounts that are maintained by the insurance company in connection with contracts under which it guarantees repayment of amounts deposited with it by an employee benefit plan, together with accrued interest at a stated rate. These contracts are referred to in this notice as "guaranteed investment contracts." [2] That exemption was proposed in response to an application filed with the Department and with the Internal Revenue Service by Aetna Life Insurance Company, the Equitable Life Assurance Society of the United States and The Prudential Insurance Company of America.[3] The notice of proposed exemption set forth a summary of the facts and representations contained in the application, and referred interested persons to the application for a complete statement of facts and representations. The application has been available for public inspection at the Department in Washington, D.C.

Public comments and a request for a hearing with regard to the proposed class exemption were received pursuant to section 408(a) of ERISA and section 4975(c)(2) of the Code and in accordance with the procedures set forth in ERISA Procedure 75-1 (40 FR 18471, April 28, 1975). Notice of a public hearing was published on November 14, 1980 (45 FR 75365), and the public hearing was held on December 8, 1980. On May 19, 1981, witnesses who appeared at the public hearing made an additional submission which amplified certain testimony.

Upon consideration of the written comments received and the testimony given at the public hearing, the Department has decided to grant a portion of the proposed exemption in an expanded form. In addition, as discussed below, the Department is also publishing in the Federal Register today a proposed class exemption that would provide significantly broader relief from the restrictions of section 406(b) of ERISA than would have been provided by the proposed exemption.[4]

DISCUSSION

The Department received three comments regarding the proposed exemption, and two witnesses testified at the public hearing. In response to these comments, the Department is adopting a final exemption that would provide unconditional relief from the restrictions of section 406(a) of ERISA for transactions involving assets held by an insurance company in a "guaranteed contract separate account" of the kind described in the exemption. In addition, the Department has also decided that it may be appropriate to provide broad relief with respect to such transactions from the restrictions on fiduciary conduct that are set forth in section 406(b) of ERISA. Although the proposed exemption provided notice to interested persons that the Department contemplated providing broad relief from section 406(a) of ERISA, the proposal provided much narrower relief from section 406(b). Therefore, the proposed exemption may not have given interested persons adequate notice that a broad exemption from section 406(b) might be issued, and may not have provided such persons with a sufficient opportunity to request a hearing or to present their views on the issues involved in such an exemption. Accordingly, the Department is publishing a separate proposed exemption that would provide relief from the fiduciary restrictions of section 406(b) of ERISA for transactions involving guaranteed contract separate accounts.

The comments received, and the Department's reasons for modifying the proposed exemption in response to those comments, are discussed below.

1. Status of Assets held by an Insurance Company Under a Guaranteed Contract Separate Account

As noted in the preamble to the proposed exemption, section 401(b)(2) of ERISA provides that if an insurance company issues a "guaranteed benefit policy" to an employee benefit plan, the assets of the plan are deemed to include the policy, but do not, solely by reason of the issuance of such policy, include any of the assets of the insurance company. In ERISA Interpretive Bulletin 75-2,[5] the Department stated that if an insurance company issues a contract or policy of insurance to a plan and places the consideration for such contract or policy in its general asset account, the assets in such account shall not be considered to be plan assets. However, in defining the term guaranteed benefit policy,[6] Congress specifically excluded amounts held by an insurance company in a separate account, and the Department has expressed its view that assets held in a separate account of an insurance company to support obligations under contracts purchased by employee benefit plans are plan assets.[7]

---

[2] This notice also refers to "guaranteed contracts;" that term includes guaranteed investment contracts and certain fixed annuity contracts that are described below.

[3] Exemption application D-780. Although this application was filed with both the Department and the Internal Revenue Service, the notice of pendency was issued, and the exemption is being granted, solely by the Department because effective December 31, 1978, section 102 of Reorganization Plan Number 4 of 1978 (43 FR 47713, October 17, 1978) transferred the authority of the Secretary of the Treasury to issue this type of exemption to the Secretary of Labor.

[4] In the discussion of the exemption, references to the various provisions of section 406 of ERISA should be read to refer as well to the corresponding provisions of section 4975 of the Code.

[5] CFR 2509.75-2.

[6] The definition of "guaranteed benefit policy" in section 401(b)(2)(B) reads as follows:

(B) The term "guaranteed benefit policy" means an insurance policy or contract to the extent that such policy or contract provides for benefits the amount of which is guaranteed by the insurer. Such term includes any surplus in a separate account, but excludes any other portion of a separate account.

The applicants for the exemption, together with two other insurance companies and the American Council of Life Insurance (collectively referred to in this notice as the "companies") urged the Department to issue an opinion that assets held in a "guaranteed investment contract separate account" of the kind described in the proposed exemption are not plan assets because such separate accounts differ in many respects from conventional separate accounts.

According to the companies, the guaranteed investment contracts that were described in the exemption application have three essential characteristics: (1) the insurance company guarantees that on the date or dates set forth in the contract the company will repay to the contract-holder the amount deposited under the contract plus accrued interest; (2) interest is accrued and credited under the contract at a fixed rate set forth in the contract; and, (3) the guarantee of repayment of principal and the stated interest are fixed, and do not vary with the investment performance of any assets held by the insurance company. These features of the contracts are the same, the companies stated, whether the deposited funds are allocated to the insurance company's general account or to a separate account that is maintained in connection with such contracts.

The companies also noted that insurance companies have different reasons for establishing separate accounts in connection with guaranteed investment contracts. For example, in some cases the investments in which the insurance company's general assets are held may not provide sufficient assurance to a company that its cash flow from investments will comport with its obligations to make payments under its guaranteed investment contracts, but, by using a separate account, the insurance company can make investments that will permit the company to collect interest and principal payments at times and in amounts that are more consistent with its guaranteed payment obligations. In addition, since an insurance company's general account investments frequently include common stocks and equity interests in real estate which, under accounting standards prescribed by state regulation, may limit the calculated yield of the general account of some insurance companies, use of a separate account may affect the guaranteed interest rates that the company is able to offer plans.

The companies asserted that assets held by an insurance company in a separate account maintained in connection with a guaranteed investment contract should not be considered plan assets because the contracts are "guaranteed benefit contracts" described in section 401(b)(2)(B) of ERISA. In this respect, the companies noted that, although it might be argued that section 401(b)(2)(B) excludes the assets of all separate accounts from those supporting a "guaranteed benefit policy," the Conference Report accompanying ERISA indicates that separate accounts were excluded because they are separately managed and the insurance company's payments generally are based on the investment performance of the assets held in the separate account.[8] Therefore, the companies stated, it would be inconsistent with the policy underlying section 401(b)(2) not to treat guaranteed investment contracts as "guaranteed benefit policies" regardless of whether they involve a separate account.

The companies also asserted that it would be consistent with the Department's proposed regulation regarding the definition of plan assets for the Department to conclude that monies held by an insurance company under a guaranteed investment contract are not plan assets.[9]

In the preamble to its proposed regulations dealing with the definition of plan assets, the Department emphasized that, with respect to a plan's investment in a wide variety of pooled investment vehicles, the plan is, as a practical matter, retaining the management of that investment vehicle to manage the plan assets that are invested in the fund, and that it appears consistent with the intent of Congress to treat the assets of such a pooled investment vehicle as plan assets.[10] However, as discussed above, the companies stated that the amounts payable, or credited to, a plan under guaranteed investment contracts are fixed and are not affected in any way by the investment performance of assets in any separate account in which monies received by the insurance company are held. Therefore, there are differences between a separate account maintained in connection with guaranteed investment contracts and other pooled separate accounts (where the value of the plan's investment is directly related to the investment management activities of the insurance company) which may be relevant to a determination whether the underlying assets of such an account are "plan assets." However, the specific exclusion of insurance company separate accounts in section 401(b)(2) of ERISA in connection with the definition of "guaranteed benefit policy" implies that assets of all separate accounts in which employee benefit plans invest should be considered plan assets.[11]

---

[7] Notice of Proposed Exemption (42 FR 54888, October 11, 1977, subsequently adopted as Prohibited Transaction Exemption 78-19 (43 FR 59915, December 22, 1978); *see also*, 29 CFR 2509.75-2.

[8] H.R. Rep. No. 1280, 93rd Cong., 2d Sess., 296-7 (1974) [1974-3 C.B. 415].

[9] Proposed 29 CFR 2550.401b-1 (44 FR 50363, August 28, 1979, and 45 FR 38084, June 6, 1980). Paragraph (a) of the proposed regulation provides, as a general rule, that plan assets include any property in which a plan has a beneficial ownership interest, and the companies asserted that monies held in a guaranteed contract separate account would not constitute "plan assets" under that rule because, when an insurance company issues a guaranteed investment contract that involves a separate account, the plan does not obtain a beneficial ownership interest in the assets of the account.

[10] 44 FR at 50364.

[11] Although, as the applicants pointed out, the Conference Report accompanying ERISA indicates that the primary reason for the special treatment given assets held in a separate account was that the investment performance of the separate account affects the amount payable to

In light of the above factors, the Department has concluded that it would be more appropriate to resolve the question of whether assets held by an insurance company in a guaranteed investment contract separate account are "plan assets" in the context of the Department's pending proposed regulation dealing with the definition of that term, and has therefore decided not to issue the ruling requested by the companies. However, as discussed more fully below, many of the characteristics of guaranteed investment contract separate accounts that were discussed by the companies in connection with the question whether assets held in such a separate account are plan assets have been important to the Department's decision to expand the scope of the exemption for transactions involving such separate accounts.

II. Market Value Adjustments

One commentator urged that the Department make certain changes to the proposed exemption to provide additional safeguards in cases where a plan enters into an insurance company contract that provides a guaranteed rate of interest, but withdraws the monies deposited with the company before the stated maturity date. This commentator referred to a case where a plan, when it withdrew amounts deposited with the insurance company, was required to choose either a lump sum payment of the amount deposited less a "market value transfer charge" equal to 25.8% of the assets held, or to accept a gradual transfer of such assets over a five-year period, during which interest at the rate of 4% per year would be paid on the assets not yet transferred. It was not clear whether the amounts deposited were held in a separate account or commingled with the insurance company's general assets.

The commentator noted that the summary of the application contained in the preamble to the proposed exemption stated that the contracts described by the applicants provide for a "market value adjustment" in some circumstances, and this reference lends an appearance of Department approbation of the practice. Therefore, the commentator suggested, the Department should either delete the reference or state that approval of the practice is not intended.

In addition, the commentator suggested three specific conditions to the proposed exemption that would provide for disclosure of certain information regarding market value adjustments and place certain limitations on the terms of contracts described in the exemption.

At the public hearing on the proposed exemption, counsel for the companies responded to the comments regarding market value adjustments. According to the companies' representative, the contracts described by the applicants generally provide for the repayment of the amounts deposited, together with interest accrued at a stated rate, on a stated "maturity" date. Although one of the companies provides in its contract for repayment of the amounts deposited at an earlier date under certain circumstances, the representative stated, an insurance company entering into such a contract generally does not contemplate that there will be an early termination by the plan. In addition, the company has no legal obligation to permit such termination. Therefore, the representative asserted, when a plan requests early withdrawal of funds held by the insurance company, the parties are dealing at arm's length, and, if interest rates have increased (relative to the rate guaranteed), then the insurance company would suffer a loss if it repaid the plan 100% of the amount deposited because the market value of the investments made with such deposits would have depreciated.

The companies' counsel also indicated that, because the investment performance of assets in a separate account is not a factor in making market value adjustments, the market value adjustment issue is not relevant to the proposed class exemption or to the applicants' request that the Department issue an interpretation that assets held in a guaranteed investment contract separate account are not plan assets.

In the final exemption, the Department has not incorporated any of the specific suggestions made by the commentator with respect to market value adjustments because the proposed exemption (and the relief being provided here) is based on the Department's conclusion that, where an insurance company unconditionally guarantees the repayment, on a fixed date, of amounts deposited together with accrued interest at a stated rate, a plan has little, if any, interest in the investment performance of assets held in a separate account to which such deposits have been allocated. The Department does not believe that this conclusion has any less validity with respect to contracts that provide for a market value adjustment when amounts deposited are withdrawn before the stated maturity date, so long as the adjustment is not made with reference to the investment performance of a separate account. However, the Department notes that the "guaranteed investment contracts" described in the proposed exemption (and in the final exemption) must provide that the plan has an unqualified right to withdraw the amounts deposited and the interest accrued thereon upon the expiration of the period for which such amounts are guaranteed under the contract. Accordingly, if a contract does not provide for such an unqualified right of withdrawal on the stated maturity date, it would not be a contract described in the exemption.

Even though no specific changes to the exemption have been made to address the issues raised with respect to market value adjustments, the Depart-

---

plans that participate in the account, it is not clear that this was the exclusive concern of the conferees. In this regard, the Conference Report explanation of the treatment of insurance company separate accounts is as follows:

> Additionally, it is understood that assets placed in a separate account managed by an insurance company are separately managed and the insurance company's payments *generally* are based on the investment performance of these particular assets. Consequently, insurance companies are to be responsible under the general fiduciary rules with respect to assets held under separate account contracts, and the assets of these contracts are to be considered as plan assets (but need not be held in trust). However, to the extent that insurance companies place some of their own funds in these separate accounts to provide for contingencies, this separate account "surplus" is not to be subject to the fiduciary responsibility rules.

H.R. Rep. No. 1280, 93 Cong., 2d Sess., 296-7(1974) (emphasis supplied).

ment is concerned with the effect of such adjustments on employee pension plans, as well as with the potential that the fiduciary responsibility provisions of ERISA may be violated in connection with arrangements that involve the imposition of such charges. In the Department's view, under the general fiduciary responsibility provisions of ERISA, when a fiduciary contemplates contracting with an insurance company, he has an obligation to fully inform himself regarding the relevant terms of the contract, including any charges that may be made in the event amounts deposited with the insurance company are withdrawn, and to take the anticipated liquidity needs of the plan into account in determining whether to enter into the contract.[12] Similarly, the Department believes that when an insurance company that contemplates entering into a contract with a plan is a fiduciary with respect to the assets involved in the transaction for any reason, it has an obligation to adhere to the fiduciary responsibility provisions of ERISA in its dealings with the plan.[13]

III. The Final Exemption

A. *Scope.* The Department has decided to grant an exemption from the restrictions of sections 406(a) and 407(a) of ERISA for any transaction involving a guaranteed contract separate account, as defined in the exemption, provided such transaction is not part of an arrangement, direct or indirect, pursuant to which a plan acquired an interest in such separate account, and provided that such transaction is not part of any other indirect transaction between a plan and a party in interest of the kind described in ERISA Interpretive Bulletin 75-2, 29 CFR 2509.75-2.[14] In addition, as noted above, in a notice also appearing in this issue of the Federal Register, the Department is proposing a broad exemption from the restrictions of section 406(b) of ERISA for transactions involving the assets of such an account. This action is being taken because the Department is persuaded, on the basis of the comments received and the testimony given at the public hearing, that an insurance company has a general obligation to pay specified amounts under guaranteed contracts of the kinds described by the companies, and its obligations under such contracts are not affected in any manner by an insurance company's allocation of monies received from a plan to a separate account.[15] In addition, the supplemental submission of the witnesses at the public hearing indicated that most insurance companies are required by state insurance law to maintain a reserve under guaranteed investment contracts that involve a separate account in an amount equal to the accumulated balance under each contract (*i.e.*, deposits under the contract, less withdrawals, plus interest accrued at the contractually guaranteed rate).[16] Therefore, the additional protections that would be afforded to plans by the imposition of the conditions of the proposed exemption would be limited. Finally, the comments received indicate that, because compliance with the conditions of the exemption as it was proposed would involve substantial burdens, fewer insurance companies would offer such contracts to plans, and plans would accordingly be deprived of investment alternatives that might otherwise be appropriate.

B. *Definitions.* As discussed below, in the final exemption, certain revisions have been made to the definition of "guaranteed investment contract" in response to the comments received, and a new term—"guaranteed contract separate account"—has been substituted for "guaranteed investment contract separate account" in order to reflect the availability of the exemption for separate accounts maintained in connection with certain fixed annuities. In addition, the final exemption contains a definition of "guaranteed fixed annuity contract."

1. *The "insulation" provision.* Under the proposed exemption, the assets of a "guaranteed investment contract separate account" would have been required to be legally segregated and not chargeable with liabilities arising out of any other business the life insurance company may conduct. The definition of the term "guaranteed contract separate account" in the final exemption does not contain this requirement.

According to the companies, although the insurance laws of various states by their terms permit an insurance company to provide in a separate account contract that the assets of the separate account are not chargeable with liabilities arising out of any other business the insurance company may conduct, these state law provisions are not mandatory and not all state laws are comparable to those statutes that authorize the inclusion of such a provision. Specifically the companies referred to a Massachusetts statute which may have the effect of prohibiting the adoption of such a provision with respect to a separate account that is maintained in connection with a guaranteed investment contract.

---

[12] See section 404(a)(1)(B) of ERISA, and the Department's regulations under that section, 29 CFR 1550.404a-1.

[13] *See e.g.* sections 404(a), 405(a), 408(b)(2) and 408(c)(2) of ERISA. An insurance company may be a fiduciary not only because it renders investment management services with respect to plan assets held in a separate account, but also for other reasons. For example, an insurance company may be a fiduciary because it renders investment advice to a plan. *See* section 3(21)(A) of ERISA.

[14] Interpretive Bulletin 75-2 describes certain indirect prohibited transactions which involve reciprocal dealing between a plan and an entity in which it invests as well as indirect prohibited transactions that result from a plan's ability to direct the affairs of an entity. These limitations are derived from the exemption application. The proposed exemption did not contain such limitations because, as was noted in the preamble to the proposed exemption, the Department believes that the arrangements and other prohibited transactions described in Interpretive Bulletin 75-2 also involve the misuse of separate plan assets and would therefore be prohibited whether or not they are expressly excluded from the exemption. However, the Department has decided to include the suggested limitations in the final exemption (and in the proposed exemption from the prohibitions of section 406(b) that is being published with this notice) in order to eliminate any uncertainty regarding the scope of the relief provided.

[15] The final exemption is limited to separate accounts maintained in connection with contracts under which, among other things, the amounts received by the plan are not, in any circumstances, affected by the investment performance of assets held in any separate account or other pooled investment fund. Thus, separate accounts maintained in connection with contracts that provide for a minimum guaranteed rate of interest and for additional interest based upon the investment performance of assets in a separate account are not covered by the exemption.

[16] The supplemental submission indicates that an additional reserve is also required in certain circumstances. In the case of certain fixed annuity contracts the consideration for which may also be held in a separate account that is covered by the exemption (discussed below), reserve requirements are based on mortality tables and interest rates approved by state insurance departments or prescribed by state law.

Although the presence or absence of an insulation provision may (depending upon the insurance company issuing the guaranteed contract) be an element in a fiduciary's consideration of whether such a contract is an appropriate investment for a plan, the Department does not believe that it is necessary for the protection of participants (or to assure that the exemption is in their interests), to limit the scope of the exemption to separate accounts that have such a provision because, in most cases, the general credit of an insurance company will provide sufficient assurance that the amounts deposited and the agreed interest (or fixed annuity payments) will actually be paid.[17]

2. *The "exclusive purpose" provision.* The applicants also objected to a portion of the definition of "guaranteed investment contract separate account" in the proposed exemption that required that such an account be "established and maintained *** for the exclusive purpose of supporting contractural obligations of *** [a] life insurance company under guaranteed investment contracts ***". In this regard, the companies stated that the reasons insurance companies maintain separate accounts in connection with guaranteed investment contracts generally involve the interest of the company, and that insurance companies invest the assets of such separate accounts in an effort to make a profit. Therefore, the companies asserted, it cannot be said that these separate accounts are maintained for the exclusive purpose of maintaining obligations under guaranteed investment contracts, and no such requirement should be imposed by the exemption.

The "exclusive purpose" requirement was included in the definition of "guaranteed investment contract separate account" in order to limit the scope of the exemption to those separate accounts that are maintained in connection with an insurance company's obligations under "guaranteed investment contracts" of the kind described. By including this requirement, the Department did not intend to restrict the reasons for which such a separate account might be established, or to limit the benefits that insurance companies might derive from establishing a separate account of this kind. Therefore, in order to clarify its intent, the Department had modified the definition to provide that an insurance company separate account will meet the requirements of the definition if it is established and maintained "solely in connection with" guaranteed contracts of the kind described in the exemption. This change is intended to remove any suggestion that a separate account would fail to be covered by the exemption merely because the use of the separate account may have been motivated by the insurance company's perception that it would be in its own best business interest to do so. However, under the revised provision, the exemption would remain unavailable for transactions involving separate accounts that are maintained, in hold or in part, to support obligations of the insurance company under contracts other than those specifically described in the exemption.

3. *Non-participating contracts providing for fixed annuities.* The companies also suggested that the scope of the exemption be expanded to include separate accounts that are maintained in connection with non-participating single premium fixed annuity contracts. According to the companies, these contracts provide for fixed annuity payments to retirees for life and the amounts payable by the insurance company under such contracts would not be affected by the investment performance of assets held in the separate account. Thus, the companies asserted, the same reasons that warrant the granting of an exemption for separate accounts used in connection with guaranteed investment contracts also
apply to separate accounts that hol
funds under non-participating fixe
annuity contracts. The Departmen
agrees, and has revised the exemptio
to include separate accounts that ar
maintained in connection with fixe
annuities of the kind described by th
companies.

GENERAL INFORMATION

The attention of interested perso
is directed to the following:

1. The fact that a transaction is th
subject of an exemption granted und
section 408(a) of the Act and sectio
4975(c)(2) of the Code does not relie
a fiduciary of a plan to which th
exemption is applicable from certa
other provisions of the Act, includi
any prohibited transaction provisio
to which the exemption does not app
and the general fiduciary responsib
ity provisions of section 404 of the A
which, among other things, require
fiduciary to discharge his duties wi
respect to the plan solely in the inter
of the plan's participants and bene
ciaries and in a prudent fashion in a
cordance with section 404(a)(1)(B)
the Act.

2. The exemption granted he
does not extend to transactions pr
hibited under section 406(b) of the A
and sections 4975(c)(1)(E) and (F)
the Code.

3. The exemption set forth herein
supplemental to, and not in derog
tion of, any other provisions of t
Act, including statutory exempti
and transitional rules. Furthermo
the fact that a transaction is subject
an administrative or statutory exem
tion is not dispositive of whether
transaction is in fact a prohibi
transaction.

EXEMPTION

In accordance with section 408(a)
the Act and section 4975(c)(2) of
Code, and based upon the entire r
ord, including the written comme
submitted in response to the notice
August 1, 1980, and the testim
given at the public hearing of Dece
ber 8, 1980, and the supplemen
submission, the Department makes
following determinations:

(i) The class exemptions set fo

---

[17] Of course, the creditworthiness of the insurance company itself would be an important factor in a fiduciary's evaluation of a guaranteed investment contract issued by the company.

herein is administratively feasible;

(ii) It is in the interests of plans and of their participants and beneficiaries; and

(iii) It is protective of the rights of participants and beneficiaries of plans.

Accordingly, the following exemption is hereby granted under the authority of section 408(a) of the Act and section 4975(c)(2) of the Code and in accordance with the procedures set forth in ERISA Procedure 75-1.

Section I. Exemption. Effective January 1, 1975, the provisions of sections 406(a) and 407(a) of the Act and the taxes imposed by reason of section 4975(c)(1)(A)-(D) of the Code shall not apply to any transaction between a guaranteed contract separate account and a party in interest, provided such transaction is not part of an arrangement, direct or indirect, pursuant to which a plan acquired an interest in such separate account, and provided such transaction is not part of any other indirect transaction between a plan and a party in interest of the kind described in ERISA Interpretive Bulletin 75-2, 29 CFR 2509.75-2.

Section II. Definitions. For the purposes of this exemption—

A. A "guaranteed investment contract" means a contract issued to an employee pension benefit plan, or to a fiduciary for the benefit for such a plan, by a life insurance company, under which—

1. The life insurance company issuing the contract guarantees the amounts deposited by the plan pursuant to such contract and guarantees a specified rate of interest on such amounts for a stated period of time;

2. The amounts received by, or credited to, a plan under such contract, and any charges made under such contract, are not, in any circumstances, affected by the investment performance of assets held in any separate account or other investment fund;

3. The plan has an unqualified right to withdraw the amounts deposited and the interest accrued thereon upon the expiration of the period for which the amounts deposited, and a specified rate of interest, are guaranteed under such contract; and,

4. The plan's right to recover any amount payable under such contract from the life insurance company issuing the contract, and the plan's claim against the general assets of such life insurance company for any amount payable under such contract, whether on insolvency or liquidation of the life insurance company or otherwise, would not be adversely affected by the allocation by the insurance company to a separate account of amounts received under such contract.

B. A "guaranteed fixed annuity contract" is an annuity contract issued by a life insurance company under which—

1. The life insurance company issuing the contract guarantees annuity payments to plan participants and beneficiaries that remain fixed at the amount specified in, or determined pursuant to schedules applicable to, the contract;

2. The amount of the annuity payable by the life insurance company is not, in any circumstances, affected by the investment performance of assets held in any separate account or other investment fund; and,

3. The annuitant's right to recover any amount payable under such contract from the life insurance company issuing the contract, and the annuitant's claim against the general assets of such life insurance company for any amount payable under such contract, whether on insolvency or liquidation of the life insurance company or otherwise, would not be adversely affected by the allocation by the insurance company to a separate account of the amounts received by it in connection with the issuance of the annuity.

C. A "guaranteed contract separate account" means a separate account that is established and maintained by an insurance company under the laws of a State solely in connection with the insurance company's contractual obligations under guaranteed fixed annuity contracts and guaranteed investment contracts.

D. The term "party in interest" includes a "disqualified person" described in section 4975(e)(2) of the Code.

(Filed by the Office of the Federal Register on September 17, 1981, 8:45 a.m., and published in the issue of the Federal Register for September 18, 1981, 46 F.R. 46443)

Chapter 45.—Windfall Profit Tax on Domestic Crude Oil

Subchapter A.—Imposition and Amount of Tax

Section 4986.—Imposition of Tax

26 CFR 150.4986-1: Imposition of tax.
(Also Sections 4995, 4997, 6050C; 150.4995-1, 150.4997-1, 150.6050C-1.)

Windfall profit tax; liability; removal of "wash" or "frac" oil. Oil purchased by a well operator and injected into an oil or gas well for well servicing or stimulating purposes is not subject to the windfall profit tax on its subsequent removal and sale.

Rev. Rul. 82-41

ISSUE

Is oil injected into an oil or gas well for well servicing or stimulating purposes upon subsequent removal subject to the crude oil windfall profit tax imposed by section 4986 of the Internal Revenue Code?

FACTS

As part of the production of crude oil, a well operator may find it necessary to inject "frac oil" or "wash oil" into the well to stimulate or maintain well production. "Frac oil," an asphaltic petroleum normally purchased from a refinery, is used for hydraulic fracturing of the producing formation to open or enlarge channels so oil can flow into the wellbore. "Wash oil," crude oil (including condensate) that is often purchased from nearby properties, is used to remove or wash accumulations of paraffins, sand, or other substances that impair the flow of oil into or from the wellbore.

"Wash oil" and "frac oil" injected into a well may become commingled with the oil in the reservoir and may be recovered, in whole or in part, as part of the subsequent production from the well.

LAW AND ANALYSIS

Section 4986 of the Code imposes an excise tax on the producer of crude oil on the windfall profit from taxable crude oil removed from the premises during each taxable period.

Section 4995(a)(1) of the Code requires, except to the extent provided in regulations, that the first purchaser of any domestic crude oil must withhold an amount equal to the tax imposed by section 4986 with respect to the oil from amounts the purchaser must pay to the producer of the oil.

Section 4997(a) of the Code requires that each operator of a well from which domestic crude oil is produced must keep such records with respect to the oil as the Secretary may prescribe by regulations.

Section 6050C of the Code requires the operator of a property from which domestic crude oil was produced to certify to the purchaser certain information regarding the windfall profit tax.

Section 150.4997-1(b) of the Temporary Excise Tax Regulations under the Crude Oil Windfall Profit Tax Act of 1980 requires that all taxpayers liable for tax under section 4986 of the Code, producers or purchasers of crude oil, operators of a property from which domestic crude oil was produced, disbursers, and partnerships or other persons receiving information on behalf of producers or providing information to producers must keep records of all documents, material, and information that are needed to determine the windfall profit tax or that affect their administrative obligations under the Act.

The taxable event for purposes of the crude oil windfall profit tax is removal of the crude oil from the premises upon which it is produced. Because "wash oil" and "frac oil" purchased by a well operator from another property or a refinery for well servicing or development purposes has been previously removed from the premises, they have already been subject to the windfall profit tax either when they were purchased by the well operator or before they were purchased. When the "wash oil" or "frac oil" which has been injected into the well is subsequently recovered, it should not be subject to the tax again.

Several states have addressed similar problems in connection with the administration of severance taxes. These states have adopted rules allowing the first production after injection of the "wash oil" or "frac oil," up to the amount of "wash oil" or "frac oil" injected, to be considered recovery of the injected oil and not subject to tax. The states require certification of the use and recovery of oil used as "wash oil" or "frac oil." The certificates take the form of state-prescribed forms, affidavits, or a combination of both. A similar approach is appropriate for purposes of the windfall profit tax.

HOLDING

When "wash oil" or "frac oil," which has been previously removed from the premises on which it was produced, is purchased for well servicing or stimulating and is injected into a well, the first crude oil produced from the well after injection, up to an amount equal to the amount injected, is considered a recovery of the "wash oil" or "frac oil." As such, it will not be considered crude oil subject to the tax imposed by section 4986 of the Code.

In addition, the purchaser of the recovered oil is not required to withhold the tax under section 4995(a)(1) of the Code, provided the operator certifies on the statement required under section 6050C(1) the amount of oil removed that represents a recovery of oil purchased for well servicing or stimulating purposes, and (2) that the operator will maintain records in accordance with section 4997(a) to substantiate the certification.

The above conclusion does not apply to "wash oil" or "frac oil" used on the premises on which it was originally produced without ever having been removed from such premises. Such oil would be subject to tax upon its subsequent recovery and removal from the premises.

The records the operator must maintain must be sufficient to document the purchase, injection, recovery, and removal or sale of the "wash oil" or "frac oil." Copies of state certificates are acceptable as records to the extent that they include the information required above. Also acceptable is any information that shows the name and business address of the vendor of the recovered oil; the volume of oil recovered and sold; the name and address of the purchaser; the date of sale; the lease name and number, well number, field, county, and reservoir of the well from which the oil was recovered, and the date of removal; the amount of any "wash oil" or "frac oil" previously recovered; whether future recovery is anticipated; and the type and amount of oil purchased for use as "wash oil" or "frac oil", the specific purpose for which it was purchased, the amount injected, the name and address of the person(s) from whom the oil was purchased and the date of the purchase.

---

26 CFR 150.4986-1: Imposition of tax.

Whether the windfall profit tax severance tax adjustment applies to taxes imposed by the States of Idaho, Louisiana, Mississippi, and Texas on the severance of crude oil. See Rev. Rul. 82-86, page 188.

---

26 CFR 150.4986-1: Imposition of tax.

Whether the windfall profit tax severance tax adjustment applies to taxes imposed by the States of Alabama, Indiana, Kentucky, Michigan, Nebraska, North Dakota, Oklahoma, South Dakota, Tennessee, Utah, and Wyoming on the severance of crude oil. See Rev. Rul. 82-87, page 189.

---

26 CFR 150.4986-1: Imposition of tax.

Whether the windfall profit tax severance tax adjustment applies to taxes imposed by the States of California, Nevada, and Ohio on the severance of crude oil. See Rev. Rul. 82-88, page 190.

---

26 CFR 150.4986-1: Imposition of tax.

Whether the windfall profit tax severance tax adjustment applies to taxes imposed by the State of Alaska on the severance of crude oil. See Rev. Rul. 82-89, page 191.

---

26 CFR 150.4986-1: Imposition of tax.

Whether the windfall profit tax severance tax adjustment applies to taxes imposed by the State of Arkansas on the severance of crude oil. See Rev. Rul. 82-90, page 192.

---

26 CFR 150.4986-1: Imposition of tax.

Whether certain West Virginia taxes qualify for the severance tax adjustment allowed in computing liability for the crude oil windfall profit tax. See Rev. Rul. 82-91, page 193.

26 CFR 150.4986-1: Imposition of tax.

Whether certain Colorado taxes qualify for the severance tax adjustment allowed in computing liability for the crude oil windfall profit tax. See Rev. Rul. 82-92, page 194.

Section 4988—Windfall Profit; Removal Price

26 CFR 150.4988-1: Windfall profit; removal price.

Windfall profit tax; depletion; intangible drilling and development costs; nonproductive well. A taxpayer incurred intangible drilling and development costs (IDC) in drilling a well to a depth below a known producing mineral deposit to test for potential mineral deposits. The additional drilling proved unsuccessful. Only the portion of the IDC reasonably allocable to the producing mineral deposit may be used to determine cost depletion for windfall profit tax purposes under section 4988(b)(3)(C)(i)(I) of the Code.

Rev. Rul. 82-71

ISSUE

How are the intangible drilling and development costs (IDC) treated for windfall profit tax purposes under section 4988(b)(3)(C)(i)(I) of the Internal Revenue Code to the extent the IDC are incurred for drilling a well to a depth below the known producing mineral deposit?

FACTS

X incurred IDC in a well drilled to a depth below the producing mineral deposit to test for other potential mineral deposits. After the additional drilling proved unsuccessful, the well was plugged back to and completed as a producer in the known producing mineral deposit. *X* made a proper election to expense IDC in the year incurred in accordance with section 1.612-4 of the Income Tax Regulations.

LAW AND ANALYSIS

Section 4988(a) of the Code defines "windfall profit" as the excess of the removal price of the barrel of crude oil over the sum of the adjusted base price of the barrel and the amount of the severance tax adjustment.

Section 4988(b) of the Code provides that the windfall profit on any barrel of crude oil shall not exceed 90 percent of the net income attributable to the barrel. The net income attributable to a barrel is the taxable income from the property attributable to taxable crude divided by the number of barrels of taxable crude oil from the property that is taken into account for the taxable year. For this purpose taxable income from the property is determined under section 613(a) without any deductions for depletion, the Windfall Profit Tax, intangible drilling and development costs under section 263(c), or qualified tertiary injectant expenses to which an election under section 4988(b)(3)(E) applies. However, section 4988(b)(3)(C) provides that in determining the net income limitation, taxable income shall be reduced by cost depletion that would have been allowable for the tax year with respect to the property if all "section 263(c) costs" had been capitalized and taken into account in computing cost depletion and cost depletion had been used by the taxpayer with respect to the property for all taxable periods. Section 4988(b)(3)(D) provides that for purposes of determining net income, the term "section 263(c) costs" means IDC incurred by the taxpayer that, by reason of an election under section 263(c), may be deducted as expense for purposes of this title. However, this term does not include costs incurred in drilling a nonproductive well.

Rev. Rul. 77-136, 1977-1 C.B. 167, establishes the principle that in certain circumstances drilling costs are to be allocated between the productive and nonproductive aspects of a well. Rev. Rul. 77-136 considered in *Situation 5* whether in computing taxable income from the property for purposes of limiting percentage depletion a taxpayer should deduct from its gross income from the property the costs of drilling wells through a producing mineral deposit to test for other mineral deposits if the wells, having proved unsuccessful, were plugged back and completed as producers in the already producing mineral deposit. Because the taxpayer had elected pursuant to the section 614(b)(2) of the Code to treat each operating mineral interest in the tract or parcel of land as a separate property, the extra costs incurred in drilling wells beyond the producing mineral deposit did not relate to the producing property. Therefore, Rev. Rul. 77-136 holds that only the portion of the total drilling costs that were reasonably allocable to the producing mineral deposit must be taken into consideration in determining taxable income from that property.

To the extent the well in this case was drilled to test for other potential mineral deposits below the producing mineral deposit, it was nonproductive. However, to the extent the well was for development of the producing mineral deposit, it was a productive well. Because section 4988(b)(3)(D) dictates that costs incurred in drilling a nonproductive well should not be treated as "section 263(c) costs" in computing the net income limitation for Windfall Profit Tax purposes, the costs of drilling the well must be allocated between the productive and nonproductive aspects of the well. Only the portion of the total IDC reasonably allocable to the producing mineral deposit should be taken into account under section 4988(b)(3)(C).

In *Situation 5* of Rev. Rul. 77-136, if the taxpayer had not elected to treat each operating mineral interest in the tract or parcel as a separate property, in computing its taxable income from the property for percentage depletion purposes, the taxpayer would have had to deduct the entire cost of drilling the well, not just the portion of the costs allocable to the producing mineral deposit. However, even if all the operating interests in the same tract or parcel are treated as a single property under section 614 of the Code, in computing the net income limitation for windfall profit tax purposes only the costs allocable to the productive aspects of the well should be taken into account because section 4988(b)(3)(D) requires costs allocable to nonproductive wells not to be considered "section 263(c) costs."

HOLDING

In the present situation, only the portion of the IDC reasonably allocable to the producing mineral deposit is used to determine cost depletion for windfall profit tax purposes under section 4988(b)(3)(C)(i)(I) of the Code.

---

26 CFR 150.4988-1: Windfall profit; removal price.

Whether the windfall profit tax severance tax adjustment applies to taxes imposed by the States of Idaho, Louisiana, Mississippi, and Texas on the severance of crude oil. See Rev. Rul. 82-86, page 188.

---

26 CFR 150.4988-1: Windfall profit; removal price.

Whether the windfall profit tax severance tax adjustment applies to taxes imposed by the States of Alabama, Indiana, Kentucky, Michigan, Nebraska, North Dakota, Oklahoma, South Dakota, Tennessee, Utah, and Wyoming on the severance of crude oil. See Rev. Rul. 82-87, page 189.

---

26 CFR 150.4988-1: Windfall profit; removal price.

Whether the windfall profit tax severance tax adjustment applies to taxes imposed by the States of California, Nevada, and Ohio on the severance of crude oil. See Rev. Rul. 82-88, page 190.

---

26 CFR 150.4988-1: Windfall profit; removal price.

Whether the windfall profit tax severance tax adjustment applies to taxes imposed by the State of Alaska on the severance of crude oil. See Rev. Rul. 82-89, page 191.

---

26 CFR 150.4988-1: Windfall profit; removal price.

Whether the windfall profit tax severance tax adjustment applies to taxes imposed by the State of Arkansas on the severance of crude oil. See Rev. Rul. 82-90, page 192.

---

26 CFR 150.4988-1: Windfall profit; removal price.

Whether certain West Virginia taxes qualify for the severance tax adjustment allowed in computing liability for the crude oil windfall profit tax. See Rev. Rul. 82-91, page 193.

---

26 CFR 150.4988-1: Windfall profit; removal price.

Whether certain Colorado taxes qualify for the severance tax adjustment allowed in computing liability for the crude oil windfall profit tax. See Rev. Rul. 82-92, page 194.

Subchapter B.—Categories of Oil

Section 4994.—Definitions and Special Rules Relating to Exemptions

26 CFR 150.4994-1: Exemptions.
(Also Sections 4995, 4997; 150.4995-2, 150.4997-2)

T.D. 7811

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PART 150—TEMPORARY EXCISE TAX REGULATIONS UNDER THE CRUDE OIL WINDFALL PROFIT TAX ACT OF 1980

Exempt royalty oil

AGENCY: Internal Revenue Service, Treasury.

ACTION: Amendment of temporary regulations.

SUMMARY: The document amends temporary excise tax regulations relating to the windfall profit tax on domestic crude oil. Changes to the applicable tax law were made by the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256]. The new temporary regulations relate to exempt royalty oil and the procedure for executing an exempt royalty owner's certificate. In addition, the text contained in the temporary regulations set forth in this document serves as the text of the proposed regulations cross-referenced in the notice of proposed rulemaking [page 572, this Bulletin].

DATE: The regulations apply to oil removed after December 31, 1981.

FOR FURTHER INFORMATION CONTACT: David R. Haglund of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3459).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On April 4, 1980, the Federal Register published temporary regulations (45 FR 23384) under sections 4986, 4987, 4988, 4989, 4991, 4992, 4993, 4994, 4995, 4996, 4997, 6050C, 6076, and 6402 of the Internal Revenue Code of 1954. The temporary regulations were required to implement various sections of the Crude Oil Windfall Profit Tax Act of 1980 [Pub. L. 76-223, 1980-3 C.B. 1]. Certain amendments to the temporary regulations have since been published. This document contains further amendments to several sections of those temporary regulations to reflect the changes made by section 601(b) of the Economic Recovery Tax Act of 1981 (Pub. Law 97-34, 95 Stat. 336 [1981-2 C.B. 256, 341]).

Section 601(b) of the Economic Recovery Tax Act of 1981 amends sections 4991, 4994 and 4995 to provide for an exemption for a qualified royalty owner's qualified royalty production. The amendment to section 4995 added subsection (a)(9) to provide the Secretary with authority to prescribe regulations for adjusting the withholding of the tax imposed by section 4986 to take into account the royalty's owner's exemption. A procedure for the adjustment of the withholding of the tax imposed by section 4986 is provided in the regulations. The temporary regulations provided by this document remain in effect until superseded by final regulations on this subject.

Section 4986 of the Code imposes a tax on the windfall profit from taxable crude oil. Section 4991 defines taxable crude oil to include all domestic crude oil other than exempt oil. Section 601(b) of the Economic Recovery Tax Act of 1981 adds "exempt royalty oil" to the class of exempt oils under section 4991(b). Section 4994(f) defines the term "exempt royalty oil" to mean that portion of the qualified royalty owner's qualified royalty production (as defined in section 6429(d)(2)) for the quarter which does not exceed the royalty limit for such quarter. For oil removed during 1982 through 1984 the royalty limit is 2 barrels per day per quarter. For oil removed after 1984 the royalty limit is 3 barrels per day per quarter.

ROYALTY OWNER'S EXEMPTION CERTIFICATE

Form 6783 is to be used by an exempt royalty owner (as defined in section 6429(d)(1)) for certifying that the entire amount of production from certain property attributable to his interest is exempt royalty oil as defined in section 4994(f). There must be reasonable belief that the production from the property to be certified plus the production from all other properties previously certified will not exceed the applicable royalty owner's exemption limit under section 4994(f)(2). The royalty owner may not certify a portion of his production from a property. For example, an exempt royalty owner with qualified production of 1½ barrels per day from property A executes an exemption certificate with respect to that property. The royalty owner also owns a royalty interest in property B with a production level of ¾ of a barrel per day. The royalty owner may not issue an exemption certificate with respect to property B since the total production, taking into account the production from both properties A and B, is more than the 2 barrels per day royalty limit. Neither can the royalty owner certify that ½ of a barrel from property B is exempt. The exempt royalty owner's certificate does not need to be filed with the Internal Revenue Service.

OTHER PROVISIONS

Where an exempt royalty owner's certificate has been furnished to the purchaser, the monthly statement to the producer required by §150.4997-2(b) shall include the number of barrels of oil for the month as if the oil had been taxable crude oil. An exempt royalty owner may also request the detailed statement under §150.4997-2(d) as if the oil removed had been taxable crude oil.

DRAFTING INFORMATION

The principal author of this regulation is David R. Haglund of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 150 is amended as follows:

Paragraph 1. Section 150.4994-1 is amended to read as follows:

§150.4994-1 Exemptions.

Section 4994 defines the terms "qualified governmental interest", "qualified charitable interest", "exempt front-end oil", "exempt Indian oil", "exempt Alaskan oil", and "exempt royalty oil", the categories of oil that are exempt from the tax imposed by section 4986.

Par. 2. Section 150.4995-2 is amended to read as follows:

1. Paragraph (a) is amended by revising the first and eighth sentences to read as set forth below.
2. Paragraph (b) is amended to read as set forth below.

§150.4995-2 Producer's certificate.

(a) *In general.* The producer of "exempt front-end oil" (as defined in section 4994(c)), "exempt Indian oil" (as defined in section 4994(d)) or "exempt royalty oil" (as defined in section 4994(f)), or the holder of any interest in crude oil that is a "qualified governmental interest" (as defined in section 4994(a)) or is a "qualified charitable interest" (as defined in section 4994(b)), may execute an exemption certificate with respect to such oil. *** Forms 6458 and 6783 are provided for this purpose. ***

(b) *Exemption certificate*—(1) *In general.* For purposes of this section, an exemption certificate is a written statement certifying that the producer's oil is exempt from the tax imposed by section 4986 because the oil constitutes exempt Indian oil, exempt front-end oil or exempt royalty oil or the oil is from a qualified governmental interest or a qualified charitable interest. Any producer who furnishes an exemption certificate (other than an exempt royalty owner's certificate) to an operator, purchaser, partnership, or other disburser shall also file an exemption certificate with the Internal Revenue Service Center, Austin, Texas (unless the producer filed the certificate with a different service center prior to January 19, 1981). Only one such certificate need be filed even though the producer may furnish certificates to more than one operator, purchaser, partnership, or other disburser.

(2) *Exempt royalty owner's certificate.* An exempt royalty owner's certificate shall certify that the producer is a qualified royalty owner (as defined in section 6429(d)(1)) and that the entire amount of production from certain property attributable to his interest is qualified royalty production (as defined in section 6429(d)(2)). No certificate may be furnished with respect to oil if it is reasonable to believe that the number of barrels attributable to the interest to be certified, taken together with all other oil with respect to which an exempt royalty owner's certificate has been furnished by the producer to any operator, purchaser, partnership, or other disburser, will exceed the producer's royalty limit amount (see section 4994(f)(2)). Allocation rules similar to the rules of section 6429(c)(2), (3), and (4) shall apply to the royalty limit amount. A certificate may be furnished with respect to oil removed after December 31, 1981.

Par. 3. Paragraphs (b)(1) and (d)(1) of §150.4997-2 are amended to read as follows:

§150.4997-2 Certain information to be furnished by purchaser and others.

* * * * *

(b) *Monthly statement*—(1) *In general.* The purchaser shall furnish statements for each calendar month showing the total amount of windfall profit tax withheld by the purchaser from payments made to the producer, operator, partnership, or disburser with respect to oil removed during that month. If the purchaser did not withhold tax from payments to that person because of the receipt of an exemption certificate, the monthly statement need only state the reason for the absence of withholding. Where an exempt royalty owner's certificate has been furnished to the purchaser, the monthly statement to the producer shall also include the number of barrels of oil removed during the month on a property-by-property basis as if the oil had been taxable crude oil.

* * * * *

(d) *Detailed statement to be furnished upon request.* (1) Any producer, operator, partnership, or disburser receiving sales proceeds from which windfall profit tax has been withheld or an exempt royalty certificate has been given may furnish the person from whom the proceeds are received a written request for some or all of the following information: The quantity of oil in each tax tier and the removal price, severance tax adjustment, adjusted base price, and tax rate applicable to that quantity. The information request may specify that the information is requested either on a property-by-property basis or in the aggregate. If an exempt royalty certificate has been given to the person receiving such a request, such person shall provide the information requested as if the oil removed had been taxable crude oil. Any person receiving such a request who has made payments to the person making the request shall provide the request information for the period and at the time specified in paragraph (d)(2).

* * * * *

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason it is found impracticable to issue it with notice and public procedure under subsection (b) of section 553 of title 5 of the United States Code or subject to the effectiveness date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in sections 4995 and 7805 of title 26 of the United States Code (95 Stat. 337 and 68A Stat. 917; 26 U.S.C. 4995 and 7805).

ROSCOE L. EGGER, JR.,
Commissioner of
Internal Revenue.

Approved February 17, 1982.

JOHN E. CHAPOTON,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on February 26, 1982, 2:40 p.m., and published in the issue of the Federal Register for March 3, 1982, 47 F.R. 8995)

Subchapter C.—Miscellaneous Provisions

Section 4995.—Withholding; Depositary Requirements

26 CFR 150.4995-1: Requirement of withholding.

Whether oil injected into an oil well for well servicing or stimulating purposes is subject to windfall profit tax. See Rev. Rul. 82-41, page 183.

26 CFR 150.4995-2: Producer's certificate.

Exempt royalty oil and the procedure for executing an exempt royalty owner's certificate. See T.D. 7811, page 186.

Section 4996.—Other Definitions and Special Rules

26 CFR 150.4996-2: Severance tax adjustment. (Also Sections 4986, 4988; 150.4986-1, 150.4988-1.)

Windfall profit tax; severance tax adjustment. The allowability of a windfall profit tax severance tax adjustment for taxes imposed by the States of Idaho, Louisana, Mississippi, and Texas is discussed.

Rev. Rul. 82-86

ISSUE

Are the crude oil production taxes imposed by the states listed below severance taxes for purposes of the crude oil windfall profit tax severance tax adjustment allowed by section 4988(a) of the Internal Revenue Code?

FACTS

The Internal Revenue Service has been asked to determine whether the following state taxes constitute severance taxes for purposes of the crude oil windfall profit tax severance tax adjustment allowed by section 4988(a) of the Code.

Idaho

Idaho Code section 47-330 imposes a tax not to exceed 5 mills a barrel on all oil and gas produced, saved, and sold or transported from the premises. The rate is set by the Oil and Gas Conservation Commission.

Idaho Code section 47-331 imposes an additional tax on oil and gas equal to 2 percent of the market value of oil and gas produced at the site of production.

Louisiana

Louisiana Revised Statutes Annotated section 47:631 imposes a tax on the severance of oil, natural gasoline, distillate, condensate, and casinghead gasoline. La. Rev. Stat. Ann. section 47:633(17) establishes rates of tax to be applied to the higher of (1) gross receipts from the first purchaser, less transportation fees, or (2) the posted field price. Under section 47:633(7)(a) the rate for oil is 12½ percent. Under section 47:633(7)(b) the rate on oil from a well incapable of producing more than 25 barrels a day and that also produces at least 50 percent saltwater is 6¼ percent. Under section 47:633(7)(c) the rate on oil from a well incapable of producing more than 10 barrels a day is 3⅛ percent.

Under section 47:633(8)(a) the tax on distillates and condensate is 12½ percent of the gross value at the time and place of severance.

Under section 47:633(8)(b) the tax on natural gasoline and casinghead gasoline is 10 cents a barrel.

Mississippi

Mississippi Code Annotated section 27-25-503 imposes a privilege tax on the business of producing or severing oil for sale, transport, storage, profit, or for commercial use. The tax is the higher of 6 cents a barrel or 6 percent of the value of the oil at the point of production.

Texas

Texas Revised Civil Statutes Annotated article 6032 (Vernon) levies a tax of 3/16 of 1 cent for each barrel of crude petroleum produced within the state.

Texas Tax-General Annotated article 4.02 (Vernon) levies an occupation tax on the production of oil of 4.6 cents a barrel, except that whenever the market value of oil is more than 1 dollar a barrel the tax is 4.6 percent of the market value plus bonuses or premiums.

APPLICABLE LAW

Section 4986 of the Code imposes a tax on the windfall profit from taxable crude oil. It is to be paid by the producer of the crude oil.

Section 4988 of the Code allows a severance tax adjustment to be taken into account in determining the amount of the windfall profit.

Section 4996(c) of the Code provides that the severance tax adjustment on a barrel of crude oil will be the amount by which (A) any severance tax imposed on the barrel exceeds (B) the severance tax that would have been imposed if the barrel had been valued at its adjusted base price. The term "severance tax" is defined as a tax (A) imposed by a state with respect to the extraction of oil, and (B) determined on the basis of the gross value of the extracted oil. Under section 4996(c)(3), a severance tax is not taken into account to the extent that the rate thereof exceeds 15 percent.

Under section 150.4996-2(b) of the Temporary Regulations under the Crude Oil Windfall Profit Tax Act of 1980 the term "severance tax" does not include a tax levied on the value of reserves in the ground or a tax levied on the basis of net proceeds from production. Furthermore, a tax on the removal of crude oil from the ground levied as a fixed fee per barrel is not a severance tax because the amount of that tax is not determined by reference to the gross value of the extracted oil.

HOLDINGS

IDAHO

The tax imposed by Idaho Code section 47-330 is based on a fixed fee per barrel and, thus, does not meet the definition of a severance tax under section 150.4996-2(b) of the temporary regulations. Therefore, it does not qualify for the severance tax adjustment.

The tax imposed by Idaho Code section 47-331 meets all of the requirements of section 4996(c) of the Code and, therefore, qualifies for the severance tax adjustment allowed by section 4988(a).

LOUISIANA

The tax imposed by La. Rev. Stat. Ann. section 47:633(8)(b) is based on a fixed fee per barrel and, thus, does not meet the definition of a severance tax under section 150.4996-2(b) of the temporary regulations. Therefore, it does not qualify for the severance tax adjustment.

The taxes imposed by La. Rev. Stat. Ann. Sections 47:633(7)(a), (b) and (c) and (8)(a) meet all of the requirements of section 4996(c) of the Code and, therefore, qualify for the severance tax adjustment allowed by section 4988(a).

MISSISSIPPI

The tax imposed by Miss. Code Ann. section 27-25-503 will vary depending on the gross value of the crude oil. Although oil valued at less than one dollar per barrel will be taxed at a fixed fee rate, the statute effectively taxes all decontrolled oil at 6 percent of gross value. Moreover, any oil that would be valued at less than one dollar per barrel would not be subject to windfall profit tax and there would be no severance tax adjustment. Thus, this tax will be treated as meeting the requirements of section 4996(c) of the Code and qualifies for the severance tax adjustment allowed by section 4988(a).

TEXAS

The tax imposed by Tex. Rev. Civ. Stat. Ann. Art. 6032 (Vernon) is based on a fixed fee per barrel and, thus, does not meet the definition of a severance tax under section 150.4996-2(b) of the temporary regulations. therefore, it does not qualify for the severance tax adjustment.

Like the Mississippi tax discussed above, the tax imposed by Tex. Tax-*Gen. Ann.* Art. 4.02 (Vernon) will vary depending on the gross value of the crude oil. This statute effectively taxes all decontrolled oil at 4.6 percent of gross value. Therefore, this tax will be treated as meeting the requirements of section 4996(c) of the Code and qualifies for the severance tax adjustment allowed by section 4988(a).

---

26 CFR 150.4996-2: Severance tax adjustment. (Also Sections 4986, 4988; 150.4986-1, 150.4988-1.)

Windfall profit tax; severance tax adjustment. The allowability of a windfall profit tax severance adjustment for taxes imposed by the States of Alabama, Indiana, Kentucky, Michigan, Nebraska, North Dakota, Oklahoma, South Dakota, Tennessee, Utah and Wyoming is discussed.

Rev. Rul. 82-87

ISSUE

Are the crude oil production taxes imposed by the states listed below severance taxes for purposes of the crude oil windfall profit severance tax adjustment allowed by section 4988(a) of the Internal Revenue Code?

FACTS

The Internal Revenue Service has been asked to determine whether the following state taxes constitute severance taxes for purposes of the crude oil windfall profit tax severance tax adjustment allowed by section 4988(a) of the Code.

Alabama

Code of Alabama title 40 section 20-2 imposes a privilege tax on the production of oil and gas measured at the rate of 6 percent of the gross value of the oil and gas at point of production. Wells producing less than 40 barrels of oil a day are taxed at the rate of 4 percent of gross value. Wells beginning production after September 1, 1979, are taxed at the rate of 4 percent of gross value, but, if the well is between 15,000 and 15,800 feet in the Smackover formation (a geologic formation in Alabama) 10 years after production begins, the rate will be 6 percent.

READEX FICHE

Ala. Code tit. 9 section 17-25 imposes an additional tax of 2 percent of gross value at point of production of crude petroleum oil and natural gas produced in Alabama for sale, transport, storage, profit, or for use.

Indiana

Indiana Code section 6-8-1-8 imposes a petroleum severance tax of 1 percent of the value of all petroleum at the time of severance.

Kentucky

Kentucky Revised Statutes section 137.120(1) imposes a tax of one-half of 1 percent of the market value of all crude petroleum produced.

Michigan

Michigan Complied Laws sections 205.301 and 205.303 impose a severance tax of 6.6 percent of the gross cash market value of oil and of 4 percent on the gross cash market value of stripper well oil.

Mich. Comp. Laws section 319.22 imposes a fee not in excess of 1 percent of the gross cash market value of oil.

Nebraska

Revised Statutes of Nebraska sections 57-701 through 57-715 impose a tax on the severance of oil. The rate of tax is 3 percent of the value of the oil except that oil produced from wells producing 10 barrels a day or less is taxes at the rate of 2 percent.

In addition, to support the Oil and Gas Conservation Fund, Neb. Rev. Stat. section 57-919 imposes a charge not to exceed 4 mills on the dollar on all oil and gas produced, saved, sold, or transported from the premises.

North Dakota

North Dakota has two taxes on the production of oil. North Dakota Century Code section 57-51-02 imposes a gross production tax of 5 percent of the gross value of oil at the well.

N.D. Cent. Code section 57-51.1-02 imposes an oil extraction tax of 6½ percent of the gross value at the well of extracted oil.

Oklahoma

Oklahoma Statutes title 68, section 1001(b) levies a tax of 7 percent of the gross value of the production of petroleum or other crude or mineral oil.

Okla. Stat. tit. 68, sec. 1101 levies an additional excise tax of 0.085 percent of the gross value of each and every barrel of petroleum oil production subject to the gross production tax.

South Dakota

South Dakota Compiled Laws Annotated section 10-39A-1 imposes a tax on the privilege of severing energy minerals equal to 4½ percent of sale price, market value, or posted field price, as applicable.

Tennessee

Tennessee Code Annotated section 60-1-301 levies a severance tax on all oil removed from the ground in Tennessee. The rate of tax is 1½ percent of the sale price.

Utah

Utah Code Annotated section 40-6-14 assesses a charge not to exceed 2 mills on the dollar on the market value at the well of all oil produced and saved, sold or transported from the premises in Utah.

Utah Code Ann. section 59-5-67 imposes an occupation tax equal to 2 percent of the value of oil at the well on every person owning an interest in the oil.

Wyoming

Wyoming Statutes section 30-5-116 assesses a charge not to exceed ⅝ of 1 mill on the dollar on the value at the well of all oil produced, saved, and sold or transported from the premises in Wyoming.

Wyo. Stat. section 39-6-302 levies an excise tax of 2 percent of the gross value of oil extracted or severed and an additional excise tax of 2 percent of the gross value of oil extracted or severed, except in the case of stripper production.

LAW AND ANALYSIS

Section 4986 of the Code imposes a tax on the windfall profit from taxable crude oil. It is to be paid by the producer of the crude oil.

Section 4988 of the Code allows a severance tax adjustment to be taken into account in determining the amount of the windfall profit.

Section 4996(c) of the Code provides that the severance tax adjustment on any barrel of crude oil will be the amount by which (A) any severance tax imposed on the barrel exceeds (B) the severance tax that would have been imposed if the barrel had been valued at its adjusted base price. The term "severance tax" is defined as a tax (A) imposed by a state on the extraction of oil and (B) determined on the basis of the gross value of the extracted oil. Under section 4996(c)(3), a severance tax is not taken into account to the extent that its rate exceeds 15 percent.

Under section 150.4996-2(b) of the Temporary Regulations under the Crude Oil Windfall Profit Tax Act of 1980, the term "severance tax" does not include a tax levied on the value of reserves in the ground or a tax levied on the basis of net proceeds from production. Furthermore, a tax on the removal of crude oil from the ground levied as a fixed fee per barrel is not a severance tax within the meaning of section 4996(c) of the Code because the amount of that tax is not determined by reference to the gross value of the extracted oil.

Each of the taxes imposed by the state statutes listed above on the extraction of oil is determined on the basis of the gross value of the extracted oil. In addition, the aggregate rate of the taxes imposed by each of the states does not exceed 15 percent.

HOLDING

The state taxes listed above are severance taxes within the meaning of section 4996(c) of the Code and may be taken into account in full for purposes of determining the severance tax adjustment.

---

26 CFR 150.4996-2: Severance tax adjustment. (Also Sections 4986, 4988; 150.4986-1, 150-4988-1.)

Windfall profit tax; severance tax adjustment. The allowability of a windfall profit tax severance tax ad-

justment for taxes imposed by the States of California, Nevada, and Ohio is discussed.

Rev. Rul. 82-88

ISSUE

Are the crude oil production taxes imposed by the states listed below severance taxes for purposes of the crude oil windfall profit tax severance tax adjustment allowed by section 4988(a) of the Internal Revenue Code?

FACTS

The Internal Revenue Service has been asked to determine whether the following state taxes constitute severance taxes for purposes of the crude oil windfall profit tax severance tax adjustment allowed by section 4988(a) of the Code.

California:

California Public Resources Code section 3402 imposes a charge to be computed at a uniform rate per barrel on the production of oil.

Nevada:

Nevada Revised Statutes section 522.150 imposes a tax of 5 mills a barrel on the production of oil in Nevada.

Ohio:

Ohio Revised Code Annotated section 5749.02 (Page) imposes a tax of 3 cents a barrel on the severance of oil.

LAW AND ANALYSIS

Section 4986 of the Code imposes a tax on the windfall profit from taxable crude oil. It is to be paid by the producer of the crude oil.

Section 4988 of the Code allows a severance tax adjustment to be taken into account in determining the amount of the windfall profit.

Section 4996(c) of the Code provides that the severance tax adjustment on any barrel of crude oil will be the amount by which (A) any severance tax imposed on the barrel exceeds (B) the severance tax that would have been imposed if the barrel had been valued at its adjusted base price. The term "severance tax" is defined as a tax (A) imposed by a state with respect to the extraction of oil, and (B) determined on the basis of the gross value of the extracted oil. Under section 4996(c)(3), a severance tax is not taken into account to the extent that its rate exceeds 15 percent.

Under section 150.4996-2(b) of the Temporary Regulations under the Crude Oil Windfall Profit Tax Act of 1980, the term "severance tax" does not include a tax levied on the value of reserves in the ground or a tax levied on the basis of net proceeds from production. Furthermore, a tax on the removal of crude oil from the ground levied as a fixed fee per barrel is not a severance tax because the amount of that tax is not determined by reference to the gross value of the extracted oil.

Each of the taxes imposed by the states listed above on the extraction of oil, is levied at a fixed fee per barrel and, thus, does not meet the definition of a severance tax under section 150.4996-2(b) of the temporary regulations.

HOLDING

The state taxes listed above are not severance taxes for purposes of the crude oil windfall profit tax severance tax adjustment allowed by section 4988(a) of the Internal Revenue Code.

---

26 CFR 150.4996-2: Severance tax adjustment. (Also Sections 4986, 4988; 150.4986-1, 150.4988-1.)

Windfall profit tax; severance tax adjustment. The allowability of a windfall profit tax severance tax adjustment for taxes imposed by the State of Alaska is discussed.

Rev. Rul. 82-89

ISSUE

Are certain crude oil production taxes imposed by the State of Alaska severance taxes for purposes of the crude oil windfall profit tax severance tax adjustment allowed by section 4988(a) of the Internal Revenue Code?

FACTS

Alaska Statutes section 43.57.010 levies a tax of ⅛ of 1 cent a barrel on oil removed or sold from each lease or property.

Alaska Stat. section 43.55.011 levies a tax equal to either a percentage-of-value amount or a cents-per-barrel amount, whichever is greater, multiplied by the economic limit factor for the property. The percentage-of-value amount is 15 percent of the gross value at point of production except that for a lease or property coming into commercial production after June 30, 1981, the percentage-of-value amount is 12.25 percent of gross value for the first 5 years after the start of commercial production and 15 percent thereafter. The cents-per-barrel amount is $0.60 a barrel for old crude oil and $0.80 for all other crude oil.

The economic limit factor for oil production of a lease or property is computed according to the following formula:

$$(1) \qquad (1 - \frac{\text{PEL}}{\text{TP}})^{\text{exp}(\frac{460 \times \text{WD}}{\text{PEL}})}$$

where: PEL = the monthly production rate at the economic limit (presumed to be 300 barrels times the number of well days, unless formally rebutted);
TP = the total production during the month for which the tax is to be paid;
WD = the total number of well days in the month for which the tax is to be paid; and

where "exp" indicates that the expression following it is an exponent.

(2) If, for any month during the first 10 years following the commencement of commercial oil production of a lease or property, the economic limit factor for oil production of that lease or property is 0.7 or less, then that factor shall be applied.

(3) If, for any month during the first 10 years following the commencement of commercial oil production of a lease or property, the economic limit factor for oil production of that lease or property is greater than 0.7, then the economic limit factor is one.

(4) The economic limit factor for oil production of a lease or property after the first 10 years following the

commencement of commercial oil production is computed under the formula in (1) above.

LAW AND ANALYSIS

Section 4986 of the Code imposes a tax on the windfall profit from taxable crude oil. It is to be paid by the producer of the crude oil.

Section 4988 of the Code allows a severance tax adjustment to be taken into account in determining the amount of the windfall profit.

Section 4996(c) of the Code provides that the severance tax adjustment on any barrel of crude oil will be the amount by which (A) any severance tax imposed on the barrel exceeds (B) the severance tax that would have been imposed if the barrel had been valued at its adjusted base price. The term "severance tax" is defined as a tax (A) imposed by a state with respect to the extraction of oil, and (B) determined on the basis of the gross value of the extracted oil. Under section 4996(c)(3), a severance tax is not taken into account to the extent that the rate exceeds 15 percent.

Under section 150.4996-2(b) of the Temporary Regulations under the Crude Oil Windfall Profit Tax Act of 1980 the term "severance tax" does not include a tax levied on the value of reserves in the ground or a tax levied on the basis of net proceeds from production. Furthermore, a tax on the removal of crude oil from the ground levied as a fixed fee per barrel is not a severance tax because the amount of that tax is not determined by reference to the gross value of the extracted oil.

The tax imposed by Alaska Stat. section 43.57.010 is based on a fixed fee per barrel. Thus, it does not meet the definition of a severance tax under section 150.4996-2(b) of the temporary regulations.

Alaska Stat. section 43.55.011 imposes a tax that is based on a cents-per-barrel amount or a percentage-of-value amount. In both cases the amount computed is subject to the economic limit factor. The smaller the economic limit factor, the smaller the tax. The economic limit factor for a property is computed with reference to a property's monthly production at the economic limit, the amount of production required to meet the monthly production costs. This means that properties with different production costs may have different economic limit factors. Therefore, it is possible that a different amount of severance tax would be imposed on properties that have production of identical gross value but different production costs. Thus, the tax under Alaska Stat. section 43.55.011 is not determined on the basis of the gross value of the oil extracted but is a tax that varies according to net proceeds. It is not a severance tax under section 150.4996-2(b) of the temporary regulations.

HOLDING

The taxes imposed by Alaska Stat. sections 43.57.010 and 43.55.011 are not severance taxes for purposes of the windfall profit tax severance tax adjustment.

---

26 CFR 150.4996-2: Severance tax adjustment. (Also Sections 4986, 4988; 150.4986-1, 150.4988-1.)

Windfall profit tax; severance tax adjustment. The allowability of a windfall profit tax severance tax adjustment for taxes imposed by the State of Arkansas is discussed.

Rev. Rul. 82-90

ISSUE

Are the taxes listed below, imposed by the State of Arkansas on the production of crude oil, severance taxes for purposes of the crude oil windfall profit tax severance tax adjustment allowed by section 4988(a) of the Internal Revenue Code?

FACTS

Arkansas imposes several taxes and charges on the severance of oil. Under Arkansas Statutes Annotated Section 84-2102(e) a tax is imposed on oil at 5 percent of the market value at time and point of severance. The statute provides a 4 percent tax rate for oil from wells producing an average of 10 barrels or less per well per day during a calendar month.

In addition there is a 5 mills a barrel tax under Ark. Stat. Ann. section 84-2102.1 to support the Arkansas Oil Museum; a 20 mill fee on each barrel of oil under Ark. Stat. Ann. section 84-2102.3; and a charge assessable by the Oil and Gas Commission under Ark. Stat. Ann. section 53-106 not to exceed 10 mills on each barrel.

Arkansas also allows two credits against the above taxes on the severance of oil. The first is a credit under Ark. Stat. Ann. sections 84-2113 through 84-2120 for the cost of maintaining an approved salt water disposal system. The credit is allowable only against the tax imposed on oil from a saltwater producing well and is further limited to a statewide maximum for all producers of $370,000 each calendar year.

The second credit, under Ark. Stat. Ann. sections 53-131 through 53-137, is a credit for the discovery of a new pool of oil. The credit is 75 percent of the tax due on the oil produced from the pool for a period of 5 or 10 years after discovery, depending on the depth of the discovery well.

LAW AND ANALYSIS

Section 4986 of the Code imposes a tax on the windfall profit from taxable crude oil. It is to be paid by the producer of the crude oil.

Section 4988 of the Code allows a severance tax adjustment to be taken into account in determining the amount of the windfall profit.

Section 4996(c) of the Code provides that the severance tax adjustment on any barrel of crude oil will be the amount by which (A) any severance tax imposed on the barrel exceeds (B) the severance tax that would have been imposed if the barrel had been valued at its adjusted base price. The term "severance tax" is defined as a tax (A) imposed by a state with respect to the extraction of oil, and (B) determined on the basis of the gross value of the extracted oil. Under section 4996(c)(3), a severance tax is not taken into account to the extent that the rate exceeds 15 percent.

Under section 150.4996-2(b) of the Temporary Regulations under the Crude Oil Windfall Profit Tax Act of 1980, the term "severance tax" does not include a tax levied on the value of reserves in the ground or a tax levied on the basis of net proceeds from production. Furthermore, a tax on the removal of crude oil from the ground levied as a fixed fee per barrel is not a severance tax because the amount of that tax is not determined by reference to the gross value of the extracted oil.

The taxes imposed by Ark. Stat. Ann. sections 84-2102.1, 84-2102.3, and 53-106 are levied as a fixed fee per barrel and, thus, do not meet the definition of a severance tax under section 150.4996-2(b) of the temporary regulations.

The taxes of 5 percent of market value and 4 percent of market value imposed by Ark. Stat. Ann. section 84-2102(e) are imposed by a state and are determined on the basis of the gross value of the extracted oil. Thus, they meet the definition of a severance tax. In two situations, however, there may be credits available against all or part of the tax.

The amount of the first credit, under Ark. Stat. Ann. sections 84-2113 through 84-2120, is determined on the basis of the cost of maintaining an approved salt water disposal system and is allowed against the tax imposed on oil from saltwater producing wells. Because the credit is based on a factor other than the gross value of the oil subject to tax, the net amount of tax payable or paid on the oil from a saltwater producing well, after being reduced by the amount of the credit, is not based on the gross value of the oil and does not meet the definition of a severance tax.

The second credit under Ark. Stat. Ann. sections 53-131, through 53-137, is for the discovery of a new pool and is determined on the basis of a percentage of the tax due on the oil from the new pool. Because the tax imposed under Ark. Stat. Ann. section 84-2102(e) is based on the gross value of the oil and the credit is based on a percentage of the tax due on the oil subject to the tax, the new pool credit against the tax is based on gross value and, thus, that amount of any tax paid after being reduced by the amount of the credit is based on gross value. The net effect of applying this credit is to tax oil from a new pool at 1¼ percent (25 percent of 5 percent) of gross value.

HOLDING

The taxes imposed under Ark. Stat. Ann. sections 84-2102.1, 84-2102.3, and 53-106, with or without any applicable credits, are not severance taxes for purposes of the severance tax adjustment to the windfall profit tax and may not be taken into account in determining windfall profit tax liability.

The taxes imposed by Ark. Stat. Ann. section 84-2102(e) are severance taxes for purposes of the severance tax adjustment to the windfall profit tax and may be taken into account in determining windfall profit tax liability. The tax imposed on oil from a saltwater producing well, however, may not be taken into account in determining windfall profit tax liability if the credit allowed under Ark. Stat. Ann. sections 84-2113 through 84-2120 is available.

---

26 CFR 150.4996-2: Severance tax adjustment. (Also Sections 4986, 4988; 150.4986-1, 150.4988-1.)

Windfall profit tax; severance tax adjustment. The allowability of a windfall profit tax severance tax adjustment for taxes imposed by the State of West Virginia is discussed.

Rev. Rul. 82-91

ISSUE

Do the taxes imposed by sections 11-13-2a and 11-13-2i of the West Virginia Code qualify as severance taxes for purposes of the severance tax adjustment allowed by section 4988(a)(2) of the Internal Revenue Code?

FACTS

Section 11-13-2a of the West Virginia Code imposes a business and occupation tax upon every person exercising the privilege of engaging or continuing within the state in the business of severing, extracting, reducing to possession, and producing for sale, profit, or commercial use any natural resource product. The amount of tax is equal to the value of the articles produced as shown by the gross proceeds derived from the sale by the producer, multiplied by the rate for the specific natural resource product. The rate for oil is 4.34%.

Section 11-13-2i of the West Virginia Code imposes a business and occupation tax upon every person engaging or continuing within the state in the business of furnishing any real or tangible personal property, which has a tax situs in the state, or any interest therein for hire, loan, lease, or otherwise, whether the return is in the form of rentals, royalties, fees, or otherwise. The tax rate is 1.15% of the gross income from the activity.

Section 11-21-3(a) of the West Virginia Code imposes an income tax on individuals, estates, and trusts. Under Section 11-21-3(d), trusts or other unincorporated organizations exempt from federal income tax are exempt from the West Virginia income tax.

Section 11-24-4 of the West Virginia Code imposes an income tax on corporations. Under section 11-24-5, various corporations are exempt from the corporate income tax.

Section 11-21-8 of the West Virginia Code allows a credit against the state individual income tax imposed by section 11-21-3 equal to the amount of liability for the year for the taxes imposed by sections 11-13-2a and 11-13-2i. The amount of the allowable credit cannot exceed the portion of the income tax attributable to West Virginia taxable income derived by the taxpayer for the taxable year from the business or occupation with respect to which the business and occupation tax was imposed. Section 11-24-9 allows a similar credit against corporate income tax imposed by section 11-24-4.

LAW AND ANALYSIS

Section 4986 of the Code imposes a tax on the windfall profit from taxable crude oil removed from the premises during each taxable period.

Under section 4988 of the Code, the term "windfall profit" means the excess of the removal price of the barrel of crude oil over the sum of (1) the adjusted base price of the barrel and (2) the amount of the severance tax adjustment with respect to the barrel provided by section 4996(c).

Section 4996(c) of the Code provides that the severance tax adjustment with respect to any barrel of crude oil is the amount by which any severance tax imposed with respect to the barrel exceeds the severance tax which would have been imposed if the barrel had been valued at its adjusted base price. For purposes of the severance tax adjustment, the term "severance tax" is defined as a tax (A) imposed by a state with respect to the extraction of oil, and (B) determined on the basis of the gross value of the extracted oil. Under section 4996(c)(3), a severance tax is not taken into account to the extent that the rate thereof exceeds 15 percent.

Section 150.4996-2(b) of the Temporary Excise Tax Regulations under the Crude Oil Windfall Profit Tax Act of 1980 defines the term "severance tax" as any tax imposed by a state (not including a political subdivision of a state) with respect to the extraction of oil that is determined on the basis of the gross value of the extracted oil. The term "severance tax" does not include a tax levied on the value of reserves in the ground or a tax levied on the basis of net proceeds from production. Furthermore, tax on the removal of crude oil from the ground levied as a fixed fee per barrel is not a severance tax because the amount of that tax is not determined by reference to the gross value of the extracted oil.

In order for a tax to be allowed as a severance tax for purposes of the severance tax adjustment, it must be imposed by a state with respect to the extraction of oil and be determined on the basis of the gross value of the extracted oil. A state that enacts a severance tax and provides that the tax is creditable dollar-for-dollar against another state tax has not *imposed a tax* within the meaning of section 4996(c)(2)(A) of the Code with respect to the extraction of the oil. Such a tax cannot be said to be determined on the basis of the gross value of the oil. Accordingly, when a tax is creditable in full against another tax, it cannot qualify as a severance tax under section 4996(c). However, when a creditable tax is imposed on a person wholly exempt from the tax against which the credit is allowed, the tax may qualify as a severance tax under section 4996(c).

HOLDING

The taxes imposed by sections 11-13-2a and 11-13-2i of the West Virginia Code do not qualify as severance taxes for purposes of the severance tax adjustment allowed by section 4988(a) of the Internal Revenue Code, except in the case of a taxpayer exempt from the West Virginia income tax under sections 11-21-3(d) or 11-24-5 of the West Virginia Code.

---

26 CFR 150.4996-2: Severance tax adjustment. (Also Sections 4986, 4988; 150.4986-1, 150.4988-1.)

Windfall profit tax; severance tax adjustment. The allowability of a windfall profit tax severance tax adjustment for taxes imposed by the State of Colorado is discussed.

Rev. Rul. 82-92

ISSUE

Whether the following Colorado charges constitute severance taxes for purposes of the severance tax adjustment allowed by section 4988(a)(2) of the Internal Revenue Code:

1. The conservation charge imposed under section 34-60-122(1) of the Colorado Revised Statutes,
2. The ad valorem property tax imposed under section 39-1-111(1) of the Colorado Revised Statutes, and
3. The severance tax imposed under section 39-29-105(1) of the Colorado Revised Statutes.

FACTS

Colo. Rev. Stat. section 34-60-122(1) imposes a charge not to exceed one mill on the dollar on the market value at the well of all oil and natural gas produced, saved, and sold or transported from the field where it was produced in the state. The rate is determined by the Colorado Oil and Gas Conservation Commissioner and the proceeds are deposited in a special fund known as the "oil and gas conservation fund."

Colo. Rev. Stat. section 39-1-111(1) authorizes counties to levy property taxes against the valuation for assessment of all taxable property located in the county on the assessment date. The assessment date is January 1, and the tax is payable on January 1 of the year following that in which it is levied. Under Colo. Rev. Stat. section 39-3-101, certain property is exempt from various state taxes, including the property tax authorized by section 39-1-111(1).

Under Colo. Rev. Stat. section 39-7-102(1), oil and gas leaseholds and lands are valued for purposes of assessment as real property, except as provided in section 39-7-102(2), at 87½ percent of the selling price of all oil or gas sold from the property during the preceding calendar year, or, if oil or gas is transported from the premises but not sold, at 87½ percent of the selling price of oil or gas sold in the same field. Under Colo. Rev. Stat. section 39-7-102(2), oil and gas leaseholds and lands employing secondary recovery, tertiary recovery, or recycling projects are valued at 75 percent of the selling price. In all cases, the selling price of all oil or gas delivered to the United States or its agencies, the state of Colorado or its agencies, or to any political subdivision of the state as royalty during the preceding calendar year is excluded.

Colo. Rev. Stat. section 39-29-105(1) imposes a tax for each tax year on the gross income from crude oil, natural gas, and oil and gas severed from the earth in Colorado. The rate varies from 2 to 5 percent, depending on the amount of the gross income. Oil produced from any wells that produce 10 barrels per day or less of crude oil for the average of all producing days during the tax year is exempt from the tax.

Colo. Rev. Stat. section 39-29-105(2) allows a credit against the tax imposed by section 39-29-105(1). The credit is equal to 87½ percent of all ad valorem taxes assessed during the tax year in the case of accrual basis taxpayers or paid during the tax year by cash basis taxpayers on (1) crude oil,

(2) natural gas, (3) oil and gas leaseholds and leasehold interests, and (4) oil and gas royalties and royalty interests for state, county, municipal school district, and special district purposes. As noted above, oil and gas property is valued, for purposes of ad valorem taxes, on the basis of the selling price of oil or gas sold or transported during the preceding calendar year. Ad valorem taxes assessed or paid on equipment and facilities used in drilling, producing, storing, and transporting crude oil and natural gas by pipeline are not included in calculating the credit.

LAW AND ANALYSIS

Section 4986 of the Code imposes an excise tax on the windfall profit from taxable crude oil removed from the premises during each taxable period.

Under section 4988(a) of the Code, the term "windfall profit" means the excess of the removal price of the barrel of crude oil over the sum of (1) the adjusted base price of such barrel, and (2) the amount of the severance tax adjustment with respect to such barrel provided by section 4996(c).

Section 4996(c) of the Code provides that the severance tax adjustment for a barrel of crude oil is the amount by which (A) any severance tax imposed on the barrel exceeds (B) the severance tax that would have been imposed if the barrel had been valued at its adjusted base price. For purposes of the severance tax adjustment, the term "severance tax" is defined as a tax (A) imposed by a state on the extraction of oil, and (B) determined on the basis of the gross value of the extracted oil.

Section 150.4996-2(b) of the Temporary Excise Tax Regulations Under the Crude Oil Windfall Profit Tax Act of 1980 defines the term "severance tax" as any tax imposed by a state (not including a political subdivision of a state) on the extraction of oil that is determined on the basis of the gross value of the extracted oil. The term "severance tax" does not include a tax levied on the value of reserves in the ground or a tax levied on the basis of net proceeds from production. Furthermore, a tax on the removal of crude oil from the ground levied as a fixed fee per barrel is not a severance tax because the amount of that tax is not determined by reference to the gross value of the extracted oil.

The conservation charge imposed by Colo. Rev. Stat. section 34-60-122(1) is imposed by the state of Colorado on the extraction of oil and is determined on the basis of the gross value of the oil. The rate is fixed by the Colorado Oil and Gas Conservation Commission, an agency of the state. Neither the fact that the tax is not called a severance tax nor the fact that the proceeds are earmarked for the oil and gas conservation fund precludes treatment of the charge as a severance tax under section 4996(c) of the Code.

The ad valorem property tax imposed under Colo. Rev. Stat. sections 39-1-111(1) and 39-7-102 is not imposed by the state. Although the tax is authorized under state law and is regulated by various state agencies, the rate is determined by the various counties and the tax is payable to them. Thus, the ad valorem property tax is imposed by political subdivisions of the state of Colorado rather than by the state.

The severance tax imposed by Colo. Rev. Stat. section 39-29-105(1), when viewed with the related credit provided in section 39-29-105(2), is not determined on the basis of the gross value of the extracted oil. Each county in the state is free to impose a different ad valorem tax. The credit allowed, and thus the net amount paid to the state as a severance tax, cannot be determined without reference to the ad valorem rates and the amount of oil removed from the properties during the preceding calendar years. Under section 4996(c) of the Code, the severance tax adjustment is computed on specific barrels of crude oil. In this case, the severance tax on each barrel is reduced by an amount unrelated to the gross value of the extracted oil.

However, if an organization subject to the severance tax imposed by Colo. Rev. Stat. section 39-29-105(1) owns oil-producing property exempt from the ad valorem property tax because of section 39-3-101, it cannot use the credit under section 39-29-105(2). If that credit is not available, the tax imposed by section 39-29-105(1) is a tax imposed by the state on the extraction of the oil and is determined on the gross value of the oil.

HOLDING

1. The conservation charge imposed under Colo. Rev. Stat. section 34-60-122(1) constitutes a severance tax for purposes of the severance tax adjustment allowed by section 4988(a)(2) of the Code.

2. The ad valorem property tax imposed under Colo. Rev. Stat. section 39-1-111(1) does not constitute a severance tax for purposes of the severance tax adjustment allowed by section 4988(a)(2) of the Code.

3. The tax imposed by Colo. Rev. Stat. section 39.29-105(1) does not constitute a severance tax for purposes of the severance tax adjustment allowed by section 4988(a)(2) of the Code, except in the case of a taxpayer whose oil-producing property is exempt from the ad valorem property tax under Colo. Rev. Stat. section 39-3-101.

Section 4997.—Records and Information; Regulations

26 CFR 150.4997-1: Returns and recordkeeping.

Whether oil injected into an oil well for well servicing or stimulating purposes is subject to windfall profit tax. See Rev. Rul. 82-41, page 183.

---

26 CFR 150.4997-2: Certain information to be furnished by purchaser and others.

Requirements and conditions for filing Form 6248, Annual Information Return of Windfall Profit Tax, on magnetic tape. See Rev. Proc. 82-10, page 414.

---

26 CFR 150.4997-2: Certain information to be furnished by purchaser and others.

Exempt royalty oil and the procedure for executing an exempt royalty owner's certificate. See T.D. 7811, page 186.

Subtitle F.—Procedure and Administration
Chapter 61.—Information and Returns
Subchapter A.—Returns and Records
Part I.—Records, Statements, and Special Returns

Section 6001.—Notice or Regulations Requiring Records, Statements, and Special Returns

26 CFR 1.6001-1: Records.

Requirements for the reproduction and private design and printing of substitute tax forms. See Rev. Proc. 82-3, page 368.

26 CFR 1.6001-1: Records.

Conditions for the acceptance of computer-prepared and computer-generated tax forms and schedules. See Rev. Proc. 82-4, page 380.

26 CFR 1.6001-1: Records.

Conditions for substitutes and reproductions of Form 1040-ES. See Rev. Proc. 82-7, page 410.

Part II.—Tax Returns or Statements
Subpart A.—General Requirement

Section 6011.—General Requirement of Return, Statement or List

Printing of substitutes for Form W-2, Wage and Tax Statement, Form W-2P, Statement for Recipients of Periodic Annuities, Pensions, Retired Pay or IRA Payments, and Form W-3, Transmittal of Income and Tax Statements. See Rev. Proc. 82-12, page 429.

26 CFR 1.6011-1: General requirement of return, statement, or list.

Requirement for the reproduction and private design and printing of substitute tax forms. See Rev. Proc. 82-3, page 368.

26 CFR 1.6011-1: General requirement of return, statement, or list.

Requirements for the reproduction and private design and printing of substitute federal tax return forms. See Rev. Proc. 82-4, page 380.

26 CFR 1.6011-1: General requirement of return, statement, or list.

Conditions for substitutes and reproductions of Form 1040-ES. See Rev. Proc. 82-7, page 410.

26 CFR 1.6011-1: General requirement of return, statement or list.

Requirements and conditions under which Forms 1042S withholding information returns may be filed on magnetic tape. See Rev. Proc. 82-13, page 447.

26 CFR 31.6011(a)-7: Execution of returns.

Conditions under which corporate officers or authorized agents may use a facsimile signature on employment tax returns. See Rev. Rul. 82-29, page 200.

Part III.—Information Returns
Subpart A.—Information Concerning Persons Subject to Special Provisions

Section 6039C.—Returns With Respect to United States Real Property Interests

Whether a Guamanian corporation that sells United States real property at a gain must comply with the filing requirements of section 6039C. See Rev. Rul. 82-114, page 104.

Subpart B.—Information Concerning Transactions with Other Persons

Section 6041.—Information at Source

26 CFR 1.6041-1: Return of information as to payments of $600 or more.
(Also Section 451; 1.451-6.)

Information returns; crop insurance proceeds. The Federal Crop Insurance Corporation (FCIC) is required to file information returns under section 6041 of the Code if payments made to farmers for crop insurance proceeds are $600 or more per year unless the farmer is required to capitalize expenses and notifies the agency. Rev. Ruls. 78-110 and 80-22 amplified.

Rev. Rul. 82-93

ISSUE

Is the Federal Crop Insurance Corporation (FCIC) required, under section 6041 of the Internal Revenue Code, to file an information return for payments to a farmer of crop insurance proceeds?

LAW AND ANALYSIS

Section 6041 of the Code requires that a return be made by all persons who are engaged in a trade or business and who make payments in the course of that trade or business totaling $600 or more a year. These payments can be in the form of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income. If such a payment is made by the United States, the return must be made by the officers or employees of the United States who have information about the payments and who are required by the regulations to file returns.

Under section 1.6041-1(g) of the Income Tax Regulations, if the payments are made by the United States, the information returns must be made by the officer or employee either of the United States or of the agency or instrumentality, as the case may be, who has control of the payments or who is designated to make the returns.

Under section 451(d) of the Code, if a taxpayer who uses the cash receipts and disbursements method of accounting has received insurance proceeds as a result of destruction or damage to crops, the taxpayer may elect to include these proceeds in income for the tax year following the tax year of destruction or damage if the taxpayer establishes that under the taxpayer's practice income from the crops would have been reported in a following tax year.

Rev. Rul. 78-110, 1978-1 C.B. 390, holds that a mutual insurance company is required to file information returns to report hail crop insurance proceeds of $600 or more paid to farmers.

Rev. Rul. 80-22, 1980-1 C.B. 286, clarifies Rev. Rul. 78-110 and holds that a mutual casualty insurance company is not required to file an information return to report hail crop insurance proceeds paid to a farmer if (1) the farmer capitalizes expenses under section 278 of the Code, relating to planting and developing citrus and almond groves, or section 447, relating to the capitalization of preproduction farm expenses, and (2) the farmer has informed the company that the expenses have been capitalized.

The FCIC is a part of the United States Department of Agriculture. It provides, for a premium, all-risk crop insurance to farmers. Payments of crop insurance proceeds by the FCIC are essentially the same as those paid by the insurance companies described in Rev. Ruls. 78-110 and 80-22, and they are subject to the same reporting requirements.

HOLDING

The FCIC is required to file an information return if payments for crop insurance proceeds made to a farmer are $600 or more a year. However, if a farmer capitalizes expenses under section 278 or 447 of the Code, and so notifies the agency, an information return by the FCIC is not required.

EFFECT ON OTHER DOCUMENTS

Rev. Ruls. 78-110 and 80-22 are amplified.

26 CFR 1.6041-1: Return of information as to payments of $600 or more.

Requirements and conditions for the printing of substitutes for information returns in the Forms 1087 and 1099 series and W-2G. See Rev. Proc. 82-5, page 406.

26 CFR 1.6041-1: Return of information as to payment of $600 or more.

Printing of substitutes for Form W-2, Wage and Tax Statement, Form W-2P, Statement for Recipients of Periodic Annuities, Pensions, Retired Pay or IRA Payments, and Form W-3, Transmittal of Income and Tax Statements. See Rev. Proc. 82-12, page 429.

26 CFR 7.6041-1: Return of information as to payments of winnings from bingo, keno, and slot machines.

Requirements and conditions for the printing of substitutes for information returns in the Forms 1087 and 1099 series and W-2G. See Rev. Proc. 82-5, page 406.

Section 6042.—Returns Regarding Payments of Dividends and Corporate Earnings and Profits

26 CFR 1.6042-2: Returns of information as to dividends paid in calendar years after 1962.

Requirements and conditions for the printing of substitutes for information returns in the Forms 1087 and 1099 series and W-2G. See Rev. Proc. 82-5, page 406.

Section 6044.—Returns Regarding Payments of Patronage Dividends

26 CFR 1.6044-2: Returns of information as to payments of patronage dividends with respect to patronage occurring in taxable years beginning after 1962.

Requirements and conditions for the printing of substitutes for information returns in the Forms 1087 and 1099 series and W-2G. See Rev. Proc. 82-5, page 406.

Section 6047.—Information Relating to Certain Trusts and Annuity and Bond Purchase Plans

26 CFR 1.6047-1: Information to be furnished with regard to employee retirement plan covering an owner-employee.

Requirements and conditions for the printing of substitutes for information returns in the Forms 1087 and 1099 series and W-2G. See Rev. Proc. 82-5, page 406.

26 CFR 1.6047-1: Information to be furnished with regard to employee retirement plan covering an owner-employee.

Printing of substitutes for Form W-2, Wage and Tax Statement, Form W-2P, Statement for Recipients of Periodic Annuities, Pensions, Retired Pay or IRA Payments, and Form W-3, Transmittal of Income and Tax Statements. See Rev. Proc. 82-12, page 429.

Section 6049.—Returns Regarding Payments of Interest

26 CFR 1.6049-1: Returns of information as to interest paid in calendar years after 1962 and original issue discount includible in gross income for calendar years after 1970.

Requirements and conditions for the printing of substitutes for information returns in the Forms 1087 and 1099 series and W-2G. See Rev. Proc. 82-5, page 406.

26 CFR 1.6049-1: Returns of information as to interest paid in calendar years after 1962 and original issue discount includible in gross income for calendar years after 1970.

Whether amount of interest to be reported on Form 1099-INT is the amount of interest on an interest-bearing checking account unreduced by service fees charged against the account. See Rev. Rul. 82-59, page 47.

Section 6050A.—Reporting Requirements of Certain Fishing Boat Operators

26 CFR 1.6050A-1: Reporting requirements of certain fishing boat operators.

Requirements and conditions for the printing of substitutes for information returns in the Forms 1087 and 1099 series and W-2G. See Rev. Proc. 82-5, page 406.

Section 6050C.—Information Regarding Windfall Profit Tax on Domestic Crude Oil

26 CFR 150.6050C-1: Information furnished by operator for purposes of windfall profit tax.

Whether oil injected into an oil well for well servicing or stimulating purposes is subject to windfall profit tax. See Rev. Rul. 82-41, page 183.

Subpart C.—Information Regarding Wages Paid Employees

Section 6051.—Receipts for Employees

26 CFR 31.6051-1: Statements for employees.

Printing of substitutes for Form W-2, Wage and Tax Statement, Form W-2P, Statement for Recipients of Periodic Annuities, Pensions, Retired Pay or IRA Payments, and Form W-3, Transmittal of Income and Tax Statements. See Rev. Proc. 82-12, page 429.

26 CFR 31.6051-2: Information returns on Form W-3 and Internal Revenue Service copies of Forms W-2.

Printing of substitutes for Form W-2, Wage and Tax Statement, Form W-2P, Statement for Recipients of Periodic Annuities, Pensions, Retired Pay or IRA Payments, and Form W-3, Transmittal of Income and Tax Statements. See Rev. Proc. 82-12, page 429.

26 CFR 31.6051-3: Statements required in case of sick pay paid by third parties.

Voluntary withholding from sick pay. See T.D. 7813, page 160.

Subpart E.—Registration of and Information Concerning Pension, etc., Plans

Section 6059.—Periodic Report of Actuary

26 CFR 301.6059-1: Periodic report of actuary. (Also Section 6692; 301.6692-1.)

T.D. 7798 [1]

---

[1] This publication of the Treasury Decision contains the complete text of the amendments to the regulations. The instructions for modifying the notice of proposed rulemaking have been omitted.

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER F, PART 301.—PROCEDURE AND ADMINISTRATION

Periodic report of actuary

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final Regulations.

SUMMARY: This document provides final regulations relating to periodic actuarial reports filed for defined benefit pension plans. Changes to the applicable tax law were made by the Employee Retirement Income Security Act of 1974 [Pub. L. 93-406, 1974-3 C.B. 1] ("ERISA"). The regulations provide necessary guidance to plan administrators who are required to file the report and to actuaries who must prepare the report.

DATES: In the case of a plan in existence on January 1, 1974, the regulations are effective for plan years beginning after December 31, 1975. In the case of a plan not in existence on January 1, 1974, the regulations are effective for plan years beginning after September 2, 1974.

FOR FURTHER INFORMATION CONTACT: George B. Baker of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W. Washington, D.C. 20224, Attention: CC:LR:T:EE-27-78, 202-566-3422 (not a toll-free number).

SUPPLEMENTARY INFORMATION

BACKGROUND

On July 8, 1980, the FEDERAL REGISTER published at 45 F.R. 45926 proposed amendments to the Procedure and Administration Regulations (26 CFR Part 301) under sections 6059 and 6692 of the Internal Revenue Code of 1954, as added by section 1033 of ERISA. A public hearing on the proposed regulations was held on November 12, 1980. After consideration of all comments regarding the proposed amendments, those amendments are adopted as revised by this Treasury decision.

ACTUARIAL REPORT

Code section 6059 requires that the plan administrator of a defined benefit pension plan subject to the minimum funding standards of ERISA periodically file an actuarial report of the plan. Under the regulations, the report is to be filed on Schedule B as an attachment to the Annual Return/Report of Employee Benefit Plan (Form 5500 series).

ACTUARY'S CERTIFICATION

Code section 6059(b) requires that an enrolled actuary certify on the actuarial report that to the best of his or her knowledge the report is complete and accurate, and that in the aggregate the actuarial assumptions used are reasonably related to the experience of the plan and to reasonable expectations and represent the actuary's best estimate of anticipated experience under the plan. Under the proposed regulations, an actuarial report would not be accepted as satisfying the filing requirements of Code section 6059 if the actuary in any manner sought to limit or qualify this required certification.

Several persons commenting on the proposed regulations took issue with this absolute prohibition. Others requested additional guidance on what might constitute a prohibited limitation or qualification. In this regard, several commentators expressed concern that the rule in the proposed regulations would discourage an enrolled actuary from including statements that the actuary believes necessary to fully describe how the report was prepared or to adequately disclose the actuarial position of the plan. Others expressed concern that the proposed rule might preclude an actuary from relying upon information customarily provided by other persons when the actuary has no reason to doubt the substantial accuracy of that information.

In response to these comments the proposed regulations have been revised by describing statements that, if included by an enrolled actuary, will not be considered to impermissibly qualify the required certification of the report's substantial accuracy or the reasonableness of the actuarial assumptions used. In general, the final regulations provide that in actuary's certification is not materially qualified by a statement on the report that the actuary relied upon information provided by another person, and that the actuary has no reason to doubt the substantial accuracy of the information. Further, if the actuary encounters error in information provided by another person, the actuary may note that the error was disregarded in preparing the report, but that the effect of the error is not material. An actuary is also free to note that any statement regarding the actuarial position of the plan is made only in light of a regulation or ruling, or in light of an interpretation of a statute, regulation or ruling, including an interpretation inconsistent with a position taken by the Internal Revenue Service. These statements by an enrolled actuary are permitted by the final regulations, but are not required.

The final regulations provide that the rules precluding the actuary from materially qualifying the required certification shall apply only with respect to reports filed for plan years ending after January 25, 1982.

GROUP DEFERRED ANNUITY CONTRACTS

One person commenting on the proposed regulations proposed that where a plan is funded entirely by the purchase of group deferred annuity contracts, an enrolled actuary should be permitted to decline any certification of the reasonableness of the actuarial assumptions specified in the contract. The final regulations provide no such exception. However, an actuary may rely upon Rev. Rul 72-557, 1972-2 C.B. 227, which sets forth three conditions which, if satisfied, will result in the actuarial assumptions underlying the contributions under the contract being deemed reasonable. As described in the revenue ruling, where the three conditions are not satisfied, the assumptons used will be considered reasonable only if, in combination, they produce reasonable results.

JOINT LIABILITY FOR PENALTY FOR FAILURE TO FILE

The proposed regulations under Code section 6692 provided that in any case in which two or more persons are responsible for a failure to file the actuarial report, then all such persons are jointly and severally liable for the $1,000 penalty imposed by that section. Under section 6692, the penalty for a failure to file an actuarial report is imposed on the plan administrator. The final regulations revise the rule relating to joint liability to make it clear that the rule should not be construed as making any person not a plan administrator liable for the penalty.

DRAFTING INFORMATION

The principal author of this regulation is George B. Baker of the Employee Plans and Exempt Organizations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, the amendments to 26 CFR Part 301 are hereby adopted:

Paragraph 1. There is added in the appropriate place the following new section:

§301.6059-1 Periodic report of actuary.

(a) *In general.* The actuarial report described in this section must be filed on behalf of a defined benefit plan to which the minimum funding standards of section 412 apply. The actuarial report must be filed by the plan administrator (within the meaning of section 414(g)) on Schedule B as an attachment to the annual Return/Report of Employee Benefit Plan (Form 5500 series). The instructions accompanying the Form 5500 series prescribe the place and date for filing Schedule B.

(b) *Plan years for which report required.* In the case of a plan in existence on January 1, 1974, Schedule B must be filed for the first plan year beginning after December 31, 1975, for which the minimum funding standards apply to the plan, and for each plan year thereafter for which the Schedule must be filed under the instructions accompanying the Schedule and the Form 5500 series. In the case of a plan not in existence on January 1, 1974, Schedule B must be filed for the first plan year beginning after September 2, 1974, for which the minimum funding standards apply to the plan, and for each plan year thereafter for which the Schedule must be filed under the instructions accompanying the Schedule and the Form 5500 series. For rules relating to when a plan is considered to be in existence, see §1.410(a)-2(c). For purposes of this section, "plan year" means the plan year as determined for purposes of the minimum funding standards.

(c) *Contents of report.* The actuarial report of a plan filed on Schedule B must contain—

(1) The date of the actuarial valuation applicable to the plan year for which the report is filed (see section 412(c)(9) for rules relating to the frequency with which an actuarial valuation of the plan is required to be made),

(2) A description of the funding method and actuarial assumptions used to determine costs under the plan,

(3) A certification of the contribution necessary to reduce the accumulated funding deficiency (as defined in section 412(a)) to zero,

(4) A statement by the enrolled actuary signing the report that to the best of the actuary's knowledge the report is complete and accurate,

(5) A statement by the enrolled actuary signing the report that in the actuary's opinion the actuarial assumptions used are in the aggregate (i) reasonably related to the experience under the plan and to reasonable expectations, and (ii) represent the actuary's best estimate of anticipated experience under the plan,

(6) Such other information as may be necessary to fully and fairly disclose the actuarial position of the plan, and

(7) Such other information as may be required by Schedule B or the instructions accompanying the Schedule and the form 5500 series.

(d) *Certification by enrolled actuary.* The actuarial report filed on Schedule B must be signed by an enrolled actuary (within the meaning of section 7701(a)(35)) or there may be attached to the report a statement signed by the actuary that contains the statements described in paragraph (c)(4) and (5) of this section. An actuarial report filed for a plan year ending after January 25, 1982, does not satisfy the requirements of this section if the actuary seeks to materially qualify such statements. For this purpose, the following are not considered to materially qualify a statement required by paragraph (c)(4) or (5) of this section:

(1) A statement that the report is based in part on information provided to the actuary by another person, that such information would customarily not be verified by the actuary, and that the actuary has no reason to doubt the substantial accuracy of the information (taking into account the facts and circumstances that are known or reasonably should be known to the actuary, including the contents of any other actuarial report prepared by the actuary for the plan).

(2) A statement that the report is based in part on information provided by another person, that the actuary believes such information is or may be inaccurate or incomplete, but that the inaccuracies or omissions are not material, the inaccuracies or ommissions are not so numerous or flagrant as to suggest that there may be material inaccuracies, and that therefore the actuarial report is substantially accurate and complete and fairly discloses the actuarial position of the plan,

(3) A statement that the report reflects the requirement of a regulation or ruling, and that any statement regarding the actuarial position of the plan is made only in light of such requirement,

(4) A statement that the report reflects an interpretation of a statute, regulation or ruling, that the actuary has no reason to doubt the validity of that interpretation, and that any statement regarding the actuarial position

of the plan is made only in light of such interpretation,

(5) A statement that in the opinion of the actuary the report fully reflects the requirements of an applicable statute, but does not conform to the requirements of a regulation or ruling promulgated under the statute that the actuary believes is contrary to the statute, or

(6) A statement furnished to comply with the requirements of paragraph (c)(6) of this section.

A statement otherwise described in a subparagraph of this paragraph (d) shall not be considered to satisfy the requirements of such subparagraph unless the statement identifies, with particularity, that matter to which the statement relates and the facts and circumstances surrounding the statement. In addition, a statement otherwise described in subparagraph (5) of this paragraph (d) shall not be considered to satisfy the requirements of that subparagraph unless the statement indicates whether an accumulated funding deficiency or a contribution that is not wholly deductible may result if the actuary's belief is determined to be incorrect.

(e) *Relief from filing.* Notwithstanding paragraph (a) of this section, the Commissioner may, in the Commissioner's discretion, relieve a plan administrator from filing Schedule B or from reporting information required by Schedule B or paragraph (c) of this section.

(f) *Penalty.* For the penalty imposed in the case of a failure to file the actuarial report required by this section, see section 6692 and §301.6692-1.

Par. 2. There is added in the appropriate place the following new section:

§301.6692-1 Failure to file actuarial report.

(a) *Penalty.* In each case in which the plan administrator (within the meaning of section 414(g)) of a defined benefit plan to which the minimum funding standards of section 412 apply fails to file the actuarial report described in section 6059 and §301.6059-1 within the time prescribed, the plan administrator shall pay a penalty of $1,000. A failure to provide a material item of information called for in the actuarial report is considered a failure to file the report. For this purpose, the signature of an enrolled actuary (see §301.6059-1(d)) is considered a material item of information. Further, for any report filed for a plan year ending after January 25, 1982, if the actuary seeks to materially qualify a statement required by §301.6059-1(c)(4) or (5) there is a failure to provide a material item of information called for in the report. For rules relating to statements not considered as materially qualifying the required statements, see §301.6059-1(d).

(b) *Failure to make actuarial valuation.* Section 412(c)(9) and the regulations thereunder prescribe the time for making an actuarial valuation of a defined benefit plan. For purposes of this section, the failure to base information called for in the actuarial report upon an actuarial valuation of the plan which is made within the time prescribed by section 412(c)(9) and the regulations thereunder is considered a failure to file the actuarial report.

(c) *Showing of reasonable cause.* The penalty imposed by this section does not apply if it is established to the satisfaction of the appropriate district director or the director of the Internal Revenue Service Center at which the actuarial report is required to be filed that the failure to file the report was due to reasonable cause. An affirmative showing of reasonable cause must be made in the form of a written statement setting forth all the facts alleged as reasonable cause. The statement must contain a declaration by the appropriate individual that the statement is made under the penalties of perjury.

(d) *Joint liability.* If more than one person is responsible as a plan administrator for a failure to file the actuarial report, all such persons are jointly and severally liable with respect to the failure.

(e) *Manner of payment.* The penalty imposed for the failure to file an actuarial report shall be paid in the same manner as a tax upon the issuance of notice and demand therefor.

(f) *Effective dates.* In the case of a plan in existence on January 1, 1974, this section is effective beginning with the first plan year beginning after December 31, 1975, for which the minimum funding standards of section 412 apply to the plan. In the case of a plan not in existence on January 1, 1974, this section is effective beginning with the first plan year beginning afte September 2, 1974, for which th minimum funding standards apply t the plan.

This Treasury decision is issued under the authority contained in sections 6059 and 7805 of the Internal Revenue Code of 1954 (88 Stat. 947, 68A Stat. 917; 26 U.S.C. 6059, 7805).

JOSEPH T. DAVIS,
Acting Commissioner of
Internal Revenue.

Approved October 21, 1981.

JOHN E. CHAPOTON,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on November 23, 1981, 8:45 a.m., and published in the issue of the Federal Register for November 24, 1981, 46 F.R. 57483)

Part IV.—Signing and Verifying of Returns and Other Documents

Section 6061.—Signing of Returns and Other Documents

26 CFR 31.6061-1: Signing of returns.
(Also Section 6011; 31.6011(a)-7.)

Returns, facsimile signatures. Corporate officers or duly authorized agents may use a facsimile signature in making returns on Forms 940, 941, and 943 subject to conditions that provide for verification of the validity of the facsimile.

Rev. Rul. 82-29

ISSUE

Under what circumstances may facsimile signatures be used on Form 940, Employer's Annual Federal Unemployment Tax Return, Form 941, Employer's Quarterly Federal Tax Return, or Form 943, Employer's Annual Tax Return for Agricultural Employees?

LAW AND ANALYSIS

Section 6061 of the Internal Revenue Code provides that any return, statement, or document required to be made under any provision of the internal revenue laws or regulations must be signed in accordance with forms or regulations.

Section 31.6061-1 of the Employment Tax Regulations provides that employment tax returns must be signed by:

(a) the individual, if the person required to make the return is an individual;

(b) the president, vice president, or other principal officer, if the person required to make the return is a corporation;

(c) a responsible and duly authorized member or officer having knowledge of its affairs, if the person required to make the return is a partnership or other unincorporated organization; or

(d) the fiduciary, if the person required to make the return is an estate or trust.

Returns may also be signed for the taxpayer by a duly authorized agent in accordance with section 31.6011(a)-7 of the regulations.

Section 31.6011(a)-7 of the regulations provides that an employment tax return may be made by an agent if an acceptable power of attorney is filed with the district director and if the return includes all taxes required to be reported by the taxpayer on the return for period covered by the return. However, except for returns of taxes imposed by the Railroad Retirement Tax Act, consolidated returns of parents and susidiaries are not permitted.

A reasonable construction of the regulations permits some flexibility with respect to the method of affixing signatures to employment tax returns.

HOLDING

Corporate officers or duly authorized agents may use a facsimile signature in making returns on Forms 940, 941, and 943, subject to the following conditions:

1. Each group of returns forwarded to the Internal Revenue Service will be accompanied by a letter signed by the person authorized to sign the returns declaring, under penalties of perjury, that the facsimile signature appearing on the returns is the signature adopted by him or her to sign the returns filed and that the signature was affixed to the returns by the officer or agent or at his or her direction. The letter must also list each return by name and identifying number.

2. A signed copy of the letter must be retained by the person filing the returns and must be available for inspection by the Service.

Part V.—Filing Returns and Other Documents

Section 6071.—Time for Filing Returns and Other Documents

26 CFR 31.6071(a)-1: Time for filing returns and other documents.

Printing of substitutes for Form W-2, Wage and Tax Statement, Form W-2P, Statement for Recipients of Periodic Annuities, Pensions, Retired Pay or IRA Payments, and Form W-3, Transmittal of Income and Tax Statements. See Rev. Proc. 82-12, page 429.

Part VI.—Extension of Time for Filing Returns

Section 6081.—Extension of Time for Filing Returns

26 CFR 1.6081-3: Automatic extension of time for filing corporation income tax returns.
(Also Sections 6152, 6164; 1.6152-1, 1.6164-1.)

Extension of time; corporate returns; net operating loss anticipated. Automatic extensions of time to file corporate income tax returns will be allowed without payment so long as Form 7004 is accompanied by Form 1138 showing an expected net operating loss that will eliminate 50 percent or more of the tentative tax shown on Form 7004. Rev. Rul. 63-222 modified.

Rev. Rul. 82-47

ISSUE

What amout of tax must be paid with Form 7004, Application for Automatic Extension of Time to File Corporation Income Tax, in order for a corporation to qualify for an election to pay tax in installments or for an extension of time to file, if the corporation also elects to extend the time for payment of part of its tax under section 6164 of the Internal Revenue Code?

FACTS

Situation 1. Corporation *X* files its income tax returns on a calendar year basis. On March 15, 1981, it filed Form 7004 for 1980 showing a tentative tax liability of 50*x* dollars. With Form 7004, *X* filed Form 1138, Extension of Time for Payment of Taxes by Corporation Expecting a Net Operating Loss Carryback, on which *X* estimated that it would have a loss for 1981 of approximately 50*x* dollars and a net operating loss carryback to 1978 that would result in an overpayment for 1978 of approximately 25*x* dollars. The tax liability for 1979 has been fully paid.

Situation 2. Same as *Situation 1,* except that *X* estimated on Form 1138 that the 1981 net operating loss would result in an overpayment for 1978 of 50*x* dollars.

Situation 3. Same as *Situation 1,* except that *X* estimated on Form 1138 that the 1981 net operating loss would result in an overpayment for 1978 of 10*x* dollars.

LAW AND ANALYSIS

Section 6081(b) of the Code provides an automatic 3-month extension of time in which a corporation may file its income tax return (Form 1120), if it files the correct form prescribed (Form 7004) and timely pays the amount properly estimated as its tax or the first installment required under section 6152.

Section 6152(a) of the Code provides that a corporation may elect to pay the unpaid amount of income tax in two equal installments.

Under section 6152(b) of the Code, the first installment must be paid on the date prescribed for payment of tax and the second installment must be paid within 3 months after that date.

Section 6164(a) of the Code provides that if a corporation files a statement (Form 1138) for an expected net operating loss carryback for the current year, the time for payment of all or part of an income tax for the immediately preceding tax year will be extended. Under section 6164(c), the amount for which payment may be extended under section 6164(a) may not exceed the amount of tax shown on the return.

Sections 6152 and 6164 of the Code allow an election to pay in installments to take effect simultaneously with an election to extend the time for paying the first installment. Taken together, sections 6152 and 6164 permit the election to be made under section 6152 even though the first installment, as well as the second, is unpaid pursuant to an extension under section 6164.

Thus, the amount for which the installment election may be made under section 6152 of the Code will be considered to be the entire tentative tax shown on Form 7004 and not merely the tentative tax less the amount deferrable under section 6164. The amount deferrable under section 6164 will be considered part or all of the payment required to be paid with Form 7004 for purposes of determining if the installment election has been made under section 6152(a), or for purposes of determining if a corporation qualifies for an extension of time to file under section 6081(b).

Accordingly, elections under section 6152(a) of the Code or automatic extensions under section 6081(b) will be valid if they are made without any accompanying payment as long as the expected carryback adjustment will eliminate 50 percent or more of the tentative tax shown on Form 7004. In other cases, the corporation must pay with Form 7004 the difference between 50 percent of the amount shown on Form 7004 and the amount of the expected carryback adjustment.

HOLDING

Situation 1. *X* is not required to send in any payment with Form 7004.

Situation 2. *X* is not required to send in any payment with Form 7004.

Situation 3. *X* must pay 15x dollars with Form 7004 (one-half of the tentative tax of 50x dollars, or 25x dollars, less 10x dollars deferred under section 6164 of the Code).

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 63-222, 1963-2 C.B. 605, which considered the same facts as those described in *Situation 1*, concluded that an election to pay in installments under section 6152 of the Code may be made or an extension of time to file under section 6081 may be allowed without any payment accompanying Form 7004 only if the expected carryback adjustment eliminated the *entire* tentative tax shown on Form 7004. In cases in which the expected overpayment of tax attributable to the anticipated loss is not sufficient to offset the tentative tax shown on Form 7004, Rev. Rul. 63-222 held that a proper payment is required to be made under section 6081(b) in order to qualify for either the extension of time to file or for the installment payment election. A proper payment was defined to be one-half of the difference between the amount shown on Form 7004 and the amount deferred under section 6164, or, under the facts in *Situation 1*, 12.5x dollars.

Rev. Rul. 63-222 is modified to hold that elections to pay in installments under section 6152 of the Code and automatic extensions of time to file under section 6081(b) will be valid without any payment accompanying Form 7004 as long as Form 7004 is accompanied by a Form 1138 that shows an expected net operating loss of 50 percent or more of the tentative tax shown on Form 7004.

---

26 CFR 1.6081-3: Automatic extension of time for filing corporation income tax returns.

From what dates should interest run on corporate income tax deferred under section 6164 if the taxpayer also files an application for automatic extension of time to file a corporation income tax return? See Rev. Rul. 82-48, page 211.

---

26 CFR 31.6081(a)-1: Extension of time for filing returns and other documents.

Printing of substitutes for Form W-2, Wage and Tax Statement, Form W-2P, Statement for Recipients of Periodic Annuities, Pensions, Retired Pay or IRA Payments, and Form W-3, Transmittal of Income and Tax Statements. See Rev. Proc. 82-12, page 429.

Part VII.—Place for Filing Returns or Other Documents

Section 6091.—Place for Filing Returns of Other Documents

Printing of substitutes for Form W-2, Wage and Tax Statement, Form W-2P, Statement for Recipients of Periodic Annuities, Pensions, Retired Pay or IRA Payments, and Form W-3, Transmittal of Income and Tax Statements. See Rev. Proc. 82-12, page 429.

Subchapter B.—Miscellaneous Provisions

Section 6103.—Confidentiality and Disclosure of Returns and Return Information

26 CFR 301.6103(c)-1: Disclosure of returns and return information (including taxpayer return information) to designee of taxpayer.

Procedures for requesting income tax returns or income tax return information to satisfy certain requirements under the Temporary Income Tax Regulations under section 103A of the Code. See Rev. Proc. 82-16, page 461.

Chapter 62.—Time and Place for Paying Tax

Subchapter A.—Place and Due Date for Payment of Tax

Section 6152.—Installment Payments

26 CFR 1.6152-1: Installment payments.

What amount of tax must be paid with Form 7004, Application for Automatic Extension of Time to File Corporation Income Tax, if a corporation elects to pay tax in installments and also elects to extend the time for payment under section 6164? See Rev. Rul. 82-47, page 201.

---

26 CFR 1.6152-1: Installment payments.

From what dates should interest run on corporate income tax deferred under section 6164 if the taxpayer also files an application for automatic extension of time to file a corporation income tax return? See Rev. Rul. 82-48, page 211.

Subchapter B.—Extensions of Time for Payment

Section 6164.—Extension of Time for Payment of Taxes by Corporations Expecting Carrybacks

26 CFR 1.6164-1: Extensions of time for payment of taxes by corporations expecting carrybacks.

What amount of tax must be paid with Form 7004, Application for Extension of Time to File Corporation Income Tax, for a corporation to qualify for an extension of time to file or an election to pay in installments if the corporation expects a net operating loss carryback and elects to extend the time for payment? See Rev. Rul. 82-47, page 201.

---

26 CFR 1.6164-1: Extensions of time for payment of taxes by corporations expecting carrybacks.

From what dates should interest run on corporate income tax deferred under section 6164 if the taxpayer also files an application for automatic extension of time to file a corporation income tax return? See Rev. Rul. 82-48, page 211.

Section 6166.—Extension of Time For Payment of Estate Tax Where Estate Consists Largely of Interest In Closely Held Business

26 CFR 20.6166-1: Election of alternate extension of time for payment of estate tax where estate consists largely of interest in closely held business.

Election to pay in installments; annual interest payments; closely held business. Failure to make annual interest payments required by section 6166(f)(1) of the Code will not trigger the accelerated payment of unpaid estate tax for the estates of decedents dying on or before December 31, 1981. However, any missed interest payments might be subject to normal collection proceedings including the levy and distraint provisions of section 6331.

Rev. Rul. 82-120

ISSUE

For purposes of the election under section 6166 of the Internal Revenue Code, will the failure to make the annual interest payments required by section 6166(f)(1) trigger the acceleration of payment of unpaid estate tax?

FACTS

The decedent died July 1, 1977. Under section 6166(a) of the Code, the executor elected to pay the estate tax attributable to an interest in a closely held business in 10 equal installments. The first installment payment of estate tax would be due on April 1, 1983. The executor was required under section 6166(f)(1) to make an interest payment annually beginning on April 1, 1979, but failed to make the first payment on or before that date.

LAW AND ANALYSIS

Under section 6166(a) of the Code, as it existed prior to amendment by the Economic Recovery Tax Act of 1981 (The Act), section 422, 1981-2 C.B. 256, 331, the executor of an estate may elect to pay all or part of the estate tax in 2 to 10 equal installments if:

(1) An interest in a closely held business is included in determining the gross estate;
(2) The value of this interest exceeds 65 percent of the adjusted gross estate; and
(3) At the date of death the decedent was a citizen or resident of the United States.

If an election is made, section 6166(a)(3) of the Code provides that the first installment payment must be made on or before a date selected by the executor that may not be more than 5 years after the due date of the estate tax return. Installments are due thereafter annually.

Under section 6166(f) of the Code, interest payments may not be deferred but must be made annually. After the 5-year deferral period, or whatever shorter period the executor selected, interest payments must be paid annually at the same time as, and as part of, each installment payment.

Section 6166(g)(3) of the Code, as it existed prior to the Act, provided that if any installment was not paid on or before the date fixed for payment, all unpaid installments were payable upon notice and demand.

Section 6166(g)(3) of the Code, as amended by the Act, provides for the estates of decedents dying after December 31, 1981, that if any payment of principal or interest is not paid on or before the date fixed for payment, all unpaid installments are payable upon notice and demand.

Under section 6166(a)(3) of the Code, the first installment is due not more than 5 years after the due date of the return. If that payment is the "first installment," an interest payment falling due before the date the first installment is due cannot be "an installment" within the meaning of section 6166(g)(3) as it existed prior to the Act's amendment.

HOLDING

Failure to make the annual interest payments required by section 6166(f)(1) of the Code will not trigger the acceleration of payment of unpaid estate tax under section 6166(g)(3) for the estates of decedents dying on or before December 31, 1981. For the estates of decedents dying after December 31, 1981, however, amended section 6166(g)(3) will generally require acceleration in the event of such missed interest payment. In addition, with regard to decedents [dying] on or before December 31, 1981, any missed interest payment under section 6166(f)(1) might be subject to normal collection proceedings including the levy and distraint provisions of section 6331.

---

26 CFR 20.6166-1: Election of alternate extension of time for payment of estate tax where estate consists largely of interest in closely held business.

In computing the amount of the estate tax charitable deduction under section 2055 of the Code for a residuary charitable bequest, what reduction is to be made for interest payable on estate taxes deferred under section 6166? See Rev. Rul. 82-6, page 137.

Section 6166A.—Extension Of Time For Payment Of Estate Tax Where Estate Consists Largely Of Interest In Closely Held Business

26 CFR 20.6166A-1: Extension of time for payment of estate tax where estate consists largely of interest in closely held business.

In computing the amount of the estate tax charitable deduction under section 2055 of the Code for a residuary charitable bequest, what reduction is to be made for interest payable on estate taxes deferred under section 6166A? See Rev. Rul. 82-6, page 137.

Chapter 64.—Collection
Subchapter A.—General Provisions

Section 6305.—Collection of Certain Liability

26 CFR 301.6305-1: Assessment and collection of certain liability.

Collection of past-due support from Federal tax refunds. See T.D. 7808, page 204.

Subchapter C.—Lien for Taxes

Section 6324B.—Special Lien For Additional Estate Tax Attributable To Farm, Etc., Valuation

For purposes of determining the amount of the lien imposed by section 6324B of the Code, what is the amount of the section 2011 credit to be used under section 2032A(c)(2)(C) in computing what would have been the estate tax liability but for the section 2032A election? See Rev. Rul. 82-35, page 128.

Chapter 65.—Abatements, Credits, and Refunds
Subchapter A.—Procedure in General

Section 6402.—Authority to Make Credits or Refunds

26 CFR 301.6402-1: Authority to make credits or refunds.
(Also Sections 4481, 7805; 41.4481-1, 301.7805-1.)

Highway use; credit or refund; Canadian trucks. Canadian trucking companies whose trucks are registered in British Columbia and who have prorate licenses under the Uniform Vehicle Registration Proration and Reciprocity Agreement may file for refunds of taxes paid on highway use for periods prior to July 1, 1981. Rev. Rul. 81-86 clarified.

Rev. Rul. 82-126

Rev. Rul. 81-86, 1981-1 C.B. 504, concerns a Canadian trucking company whose trucks are registered in British Columbia. Under the Uniform Vehicle Registration Proration and Reciprocity Agreement, the company has received prorate licenses from Washington, Oregon, and California to operate in those states. The ruling holds that these prorate licenses constitute registration for purposes of the highway use tax imposed by section 4481(a) of the Internal Revenue Code and thus the company is liable for the tax on the use of its vehicles on the public highways of the United States. Rev. Rul. 81-86, however, also provides that it does not apply to the use of vehicles on the public highways prior to July 1, 1981.

Held, under section 6402(a) of the Code, Canadian truckers described in Rev. Rul. 81-86 who paid the highway use tax for periods prior to July 1, 1981, may file for a refund of these taxes on Form 843, Claim, with the Internal Revenue Service Center, Philadelphia, PA 19255.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 81-86 is clarified.

---

26 CFR 304.6402-1: Offset of past-due support against overpayments.
(Also Section 6305; 301.6305-1.)

T.D. 7808

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER F, PART 301.—PROCEDURE AND ADMINISTRATION; PART 304.—TEMPORARY REGULATIONS UNDER TITLE 13 OF THE OMNIBUS BUDGET RECONCILIATION ACT OF 1981

Collection of past-due support from Federal tax refunds

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations; final regulations.

SUMMARY: This document contains temporary regulations and certain final regulations on procedure and administration relating to the collection of past-due support from Federal tax refunds. Changes to the law were made by the Omnibus Budget Reconciliation Act of 1981 [Pub. 97-35, 1981-2 C.B. 528]. These regulations affect all taxpayers who are owed refunds for a taxable year and who are liable for past-due support. In addition, the text of the temporary regulations set forth in this document serves as the text of the proposed regulations cross-referenced in the notice of proposed rulemaking*** [LR-189-81, page 565, this Bulletin].

DATE: These temporary and final regulations are effective October 1, 1981.

FOR FURTHER INFORMATION CONTACT: Susan K. Thompson of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution, N.W., Washington, D.C. 20224 [Attention: CC:LR:T] 202-566-3294.

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains temporary regulations on procedure and administration relating to the collection of past-due support from Federal tax refunds under section 464 of Part D of Title IV of the Social Security Act and section 6402(c) of the Internal Revenue Code of 1954, as added by section 2331(a) of Title 13 of the Omnibus Budget Reconciliation Act of 1981 [Pub. L. 97-35, 95 Stat. 357]. Also contained in this document are final regulations on procedure and administration conforming the regulations to certain changes made to section 6305 of the Internal Revenue Code of 1954. Section 6305 incorporates by reference section 452(b) of the Social Security Act. That Act was amended by section 2332(b) and (g) of the Omnibus Budget Reconciliation Act of 1981 to include within the collection procedures provided for in section 6305 child and spousal support obligations and obligations for support fixed by order of a State administrative process (as well as those determined by court order). Further, a new Part 304, Temporary Regulations under Title 13 of the Omnibus Budget Reconciliation Act of 1981, is added by this document to Title 26 of the Code of Federal Regulations. The temporary regulations provided by this document will remain in effect until superseded by final regulations on this subject.

EXPLANATION OF PROVISIONS

Under new section 6402(c), the Secretary of the Treasury is required to offset amounts of past-due support from the amount of any overpayment to be refunded to a taxpayer who owes this support.

The term "past-due support" is defined in the regulations as the amount of a delinquency, determined under a court order or an order of an administrative process established under State law, for support and maintenance of a child or of a child and the parent with whom the child is living. Only amounts of support that are $150.00 or greater, that are at least three months delinquent, and that have been assigned to a State under section 402(a)(26) of the Social Security Act (as a condition for eligibility for aid and service to needy families with children) are eligible for this new offset procedure.

The regulations provide that a State to which this support has been assigned under the Social Security Act shall notify the Department of Health and Human Services, Office of Child Support Enforcement of the amount of past-due support, the name and social security number of the parent owing the support, and the alphabetical designation of the State submitting the notification. The Office of Child Support Enforcement will consolidate this information and transmit it to the Internal Revenue Service on behalf of the participating States.

The Internal Revenue Service will determine whether an overpayment exists against which the past-due support may be offset and will make the offset after a crediting of the overpayment to any outstanding existing liability for any tax owed by the person making the overpayment. The Internal Revenue Service will notify the taxpayer of the amount and date of the offset, and of the State which submitted the notification of liability for past-due support.

Monies collected by offset will be transferred to a special account maintained by the Bureau of Government Financial Operations and, after authorization of the Division of Finance of the Social Security Administration, will be transmitted to the States. The Office of Child Support Enforcement will be notified of the name and social security number of the taxpayer from whom the past-due support was collected, the amount and date of the offset, and the State which submitted the notification of liability for past-due support for that taxpayer. Although section 464(a) of the Social Security Act also requires the Internal Revenue Service to notify the participating States of the home addresses of the taxpayers from whom the past-due support was collected, the Office of Child Support Enforcement has agreed to obtain these addresses on behalf of the States through its Parent Locator Service. Thus, the regulations do not make separate provision for the transmittal of these addresses.

Evaluation of the effectiveness of these regulations will be based on comments received from officers within the Treasury and the Internal Revenue Service, other governmental agencies, and the public.

WAIVER OF PROCEDURAL REQUIREMENTS OF TREASURY DIRECTIVE

There is need for expeditious adoption of the provisions contained in this document because of the need for immediate guidance to States submitting notifications of liability for past-due support by October 1, 1981. For this reason, Roscoe L. Egger, Jr., Commissioner of Internal Revenue, has determined that the provisions of paragraph 8 through 14 of Treasury Directive 50.04F for improving government regulations must be waived.

DRAFTING INFORMATION

The principal author of these regulations is Susan K. Thompson of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, on matters of both substance and style.

Adoption of amendments to the regulations

Accordingly, a new Part 304, Temporary Regulations under Title 13 of the Omnibus Budget Reconciliation Act of 1981 is added to Title 26 of the Code of Federal Regulations, and the following temporary and final regulations are adopted:

Paragraph 1. Section 301.6305-1(a), (b)(1), (2), (4), and (6), and (c)(4) is amended to read as follows:

§301.6305-1 Assessment and collection of certain liability.

(a) *Scope*. Section 6305(a) requires the Secretary of the Treasury or his delegate to assess and collect amounts which have been certified by the Secretary of Health and Human Services as the amount of a delinquency determined under a court order, or an order of an administrative process established under State law, for support and maintenance of a child or of a child and the parent with whom the child is living. These amounts, referred to as "child and spousal support", are to be collected in the same manner and with the same powers exercised by the Secretary of the Treasury or his delegate in the collection of an employment tax which would be jeopardized by delay. However, where the assessment is the first assessment against an individual for a delinquency described in this paragraph for a particular individual or individuals, the collection is to be stayed for a period of 60 days following notice and demand. In addition, no interest or penalties (with the exception of the penalties imposed by sections 6332(c)(2) and 6657) shall be assessed or collected on the amounts, paragraphs (4), (6) and (8) of section 6334(a) (relating to property exempt from levy) shall not apply; and, there shall be exempt from levy so much of the salary, wages, or other income of the individual which is subject to garnishment pursuant to a judgment entered by a court for the support of his or her minor children. Section 6305(b) provides that sole jurisdiction for any action brought to restrain or review assessment and collection of the certified amounts shall be in a State court or a State administrative agency.

(b) *Assessment and collection*—(1) *General rule*. Upon receipt of a certification or recertification from the Secretary of Health and Human Services or his delegate under section 452(b) of Title IV of the Social Security Act as amended (relating to collection of child and spousal support obligations with respect to an individual), the district director or his delegate shall assess and collect the certified amount (or recertified amount). Except as provided in paragraph (c) of this section, the amount so certified shall be assessed and collected in the same manner, with the same powers, and subject to the same limitations as if the amount were an employment tax the collection of which would be jeopardized by delay. However, the provisions of subtitle F with respect to assessment and collection of taxes shall not apply with respect to assessment and collection of a certified amount where such provisions are clearly inappropriate to, and incompatible with, the collection of certified amounts generally. For example, section 6861(g) which allows the Secretary or his delegate to abate a jeopardy assessment if he finds a jeopardy does not exist will not apply.

(2) *Method of assessment.* An assessment officer appointed by the district director pursuant to §301.6203-1 to make assessments of tax shall also make assessments of certified amounts. The assessment of a certified amount shall be made by the assessment officer signing the summary record of assessment. The date of assessment is the date the summary record is signed by the assessment officer. The summary record, through supporting records as necessary, shall provide—

(i) The assessed amount;

(ii) The name, social security number, and last known address of the individual owing the assessed amount;

(iii) A designation of the assessed amount as a certified amount, together with the date on which the amount was certified and the name, position, and governmental address of the officer of the Department of Health and Human Services who certified the amount;

(iv) The period to which the child and spousal support obligation represented by the certified amount relates;

(v) The State in which was entered the court or administrative order giving rise to the child and spousal support obligation represented by the certified amount;

(vi) The name of the person or persons to whom the child and spousal support obligation represented by the certified amount is owed; and

(vii) The name of the child or children or the parent of the child or children for whose benefit the child and spousal support obligation exists.

Upon request, the individual assessed shall be furnished a copy of pertinent parts of this assessment which set forth the information listed in subdivision (i) through (vii) of this paragraph (b)(2).

* * * * *

(4) *Method of collection.****

(iii) The district director or his delegate may offset the amount of any overpayment of any internal revenue tax (as described in section 301.6401-1) to be refunded to the person making the overpayment by the amount of any past-due support (as defined in the regulations under section 6402) owed by the person making the overpayment. The amounts offset under section 6402(c) may be amounts of child and spousal support certified (or recertified) for collection under section 6305 and this section or they may be amounts of past-due support of which the Secretary of the Treasury has been notified under section 6402(c) and the regulations under that section.

* * * * *

(6) *Disposition of certified amounts collected.* Any certified amount collected shall be deposited in the general fund of the United States, and the officer of the Department of Health and Human Services who certified the amount shall be promptly notified of its collection. There shall be established in the Treasury, pursuant to section 452 of Title IV of the Social Security Act as amended, a revolving fund which shall be available to the Secretary of Health and Human Services or his delegate, without fiscal year limitation, for distribution to the States in accordance with the provisions of section 457 of the Act. Section 452(c)(2) of the Act appropriates to this revolving fund out of any monies not otherwise appropriated, amounts equal to the certified amounts collected under this paragraph reduced by the amounts credited or refunded as overpayments of the certified amounts so collected. The certified amounts deposited shall be transferred at least quarterly from the general fund of the Treasury to the revolving fund on the basis of estimates made by the Secretary of the Treasury or his delegate. Proper adjustments shall be made in the amounts subsequently transferred to the extent prior estimates were in excess of or less than the amounts required to be transferred. See, however, paragraph (c)(1) of this section for the special rule requiring retention in the general fund of certain penalties which may be collected.

(c) *Additional limitations and conditions.****

(4) *First assessment.* In the case of a first assessment against an individual for a certified amount in whole or part for the benefit of a particular child or children or the child or children and their parent, the collection of the certified amount shall be stayed for the period of 60 days immediately following notice and demand as described in section 6303. However, no other stay of the collection of a certified amount may be granted. Thus, the provisions of section 6863(a), relating to bonds to stay collection of jeopardy assessments, shall not apply to the collection of certified amounts.

* * * * *

Par. 2. Section 301.6402-1 is amended to read as follows:

§301.6402-1 Authority to make credits or refunds.

The Commissioner, within the applicable period of limitations, may credit any overpayment of tax, including interest thereon, against any outstanding liability for any tax (or for any interest, additional amount, addition to the tax, or assessable penalty) owed by the person making the overpayment and the balance, if any, shall be refunded, subject to section 6402(c) and the regulations thereunder, to that person by the Commissioner.

Par. 3. Section 301.6402-3(a)(6) is amended to read as follows:

§301.6402-3 Special rules applicable to income tax.

(a) ***

(6) Notwithstanding paragraph (a)(5) of this section, the Commissioner, within the applicable period of limitations, may credit any overpayment of individual, fiduciary, or corporation income tax, against any outstanding liability for any tax (or for any interest, additional amount, additions to the tax, or assessable penalty) owed by the taxpayer making the overpayment. After crediting an overpayment of tax

by an individual taxpayer against any outstanding liability for any tax or other amount described in the preceding sentence, the Commissioner shall offset the balance, if any, of the overpayment by amounts of past-due support under procedures set forth in the regulations under section 6402(c). Only the balance, if any, of the overpayment remaining after credit against outstanding liability for tax or other amount and offset of past-due support shall be treated in the manner so elected.

Par. 4. A new Part 304 is added to Title 26 of the Code of Federal Regulations:

PART 304—TEMPORARY REGULATIONS UNDER TITLE 13 OF THE OMNIBUS BUDGET RECONCILIATION ACT OF 1981

§304.6402-1 Offset of past-due support against overpayments.

Authority: 26 U.S.C. 7805, unless otherwise noted.

Par. 5. A new §304.6402-1 is added to Part 304 which reads as follows:

§304.6402-1 Offset of past-due support against overpayments.

(a) *Introduction*—(1) *Scope*. Section 6402(c) requires the Secretary of the Treasury or his delegate to reduce the amount of any overpayment to be refunded to a person making an overpayment by the amount of past-due support owed by that person of which the Secretary has been notified in accordance with section 464 of the Social Security Act. Past-due support shall be collected by offset under section 6402(c) and this section in the same manner as if it were a liability for tax imposed by the Internal Revenue Code of 1954 (except that a liability for tax shall be given priority with respect to offset arising under section 6402(a)). Collection by offset under section 6402(c) of this section is a collection procedure separate from the collection procedures provided by section 6305 and §301.6305-1, relating to assessment and collection of certain child and spousal support liabilities. The sole collection procedure provided by section 6402(c) and this section is that of offset against overpayment. Section 6305 and §301.6305-1, by contrast, provide for other collection procedures in addition to collection by offset against overpayment. Sections 6305 and 6402(c) have differing procedural requirements and may be used separately or in conjunction with each other.

(2) *General rule*. An amount of past-due support qualifies for offset under this section if it satisfies the requirements of paragraph (b) of this section. A State shall submit to the Department of Health and Human Services a notification of liability for qualifying past-due support containing the information described in paragraph (c) of this section. A qualifying amount of past-due support owed by a taxpayer who has made an overpayment shall be collected in accordance with the procedures set forth in paragraph (d) of this section. Under paragraph (d), the balance of any overpayment remaining after crediting of the overpayment under section 6402(a) to any liability for an internal revenue tax on the part of the taxpayer shall be offset by the amount of past-due support of which the Internal Revenue Service has been notified. The amount of the overpayment not subject to offset for any liability for an internal revenue tax or for past-due support shall be promptly refunded to the taxpayer. Paragraph (e) of this section requires that the Internal Revenue Service notify the taxpayer of the amount of the offset and of the State to which it has been paid. Under procedures set forth in paragraph (f) of this section, amounts collected by offset shall be transferred to a special account maintained by the Bureau of Government Financial Operations for distribution to the States. The Internal Revenue Service shall make monthly collection reports to the Secretary of Health and Human Services or his delegate. The States shall reimburse the Secretary of the Treasury for the full cost of the refund offset under paragraph (g) of this section.

(b) *Past-due support*—(1) *Definition*. For purposes of this section, the term "past-due support" means the amount of a delinquency, determined under a court order, or an order pursuant to an administrative process established under State law, for support and maintenance of a child or of a child and the parent with whom the child is living.

(2) *Past-due support qualifying for offset*. Past-due support qualifies for offset under section 6402(c) and this section if—

(i) There has been an assignment of the support obligation to a State pursuant to section 402(a)(26) of the Social Security Act (relating to aid and service to needy families with children) and that State has made reasonable efforts to collect the amount of the obligation;

(ii) The amount of past-due support is not less than $150.00;

(iii) The past-due support has been delinquent for three months or longer; and

(iv) A notification of liability for past-due support has been received by the Secretary of the Treasury as prescribed by paragraph (c) of this section.

(c) *Notification of liability for past-due support*—(1) *Form*. A State shall, by October 1 of each year, submit a notification (or notifications) of liability for past-due support on magnetic tape to the Special Collection Activities Unit, Office of Child Support Enforcement, Department of Health and Human Services, 6110 Executive Boulevard, Suite 900, Rockville, Maryland 20852, Attention: Tax Refund Offset - Tape Processing.

(2) *Content*. The notification of liability for past-due support shall contain with respect to each taxpayer—

(i) The name of the taxpayer who owes the past-due support;

(ii) The social security number of that taxpayer.

(iii) The amount of past-due support owed; and

(iv) The alphabetical designation of the State submitting the notification of liability for past-due support.

The Secretary of Health and Human Services may also require such other information from the State submitting the notification as is necessary for his orderly consolidation of data for transmittal to the Internal Revenue Service.

(3) *Transmittal of notification to Internal Revenue Service.* The Secretary of Health and Human Services shall, by December 1 of each year, consolidate and transmit to the Internal Revenue Service on magnetic tape the data contained in the notifications of liability for past-due support submitted by the participating States.

(4) *Correction of notification.* If, after submitting a notification of liability for past-due support, a State determines that an error has been made with respect to the information contained in the notification, or if a State receives a payment or credits a payment to the account of a taxpayer named in this notification, the State shall promptly notify the Internal Revenue Service and the Internal Revenue Service shall make the appropriate correction of the notification of liability for past-due support. However, in no case shall a State notify the Internal Revenue Service under this paragraph (c)(4) of an increased amount of past-due support owed by a taxpayer named in its notification of liability for past-due support. The correction notification described in this paragraph (c)(4) is to be submitted only for the purpose of completing or correcting the information contained in the notification of liability for past-due support.

(d) *Collection*—(1) *Priority of offset for outstanding tax liability.* Under section 6402(a) and §301.6402-1, the Commissioner may credit any overpayment of tax against any outstanding liability for any tax owed by the person making the overpayment. Only the balance remaining after such crediting is available for offset under section 6402(c) of this section. Thus, if a taxpayer making an overpayment has both an outstanding tax liability and a liability for past-due support subject to this section, then the entire amount of the overpayment shall be credited first against the outstanding tax liability under section 6402(a) and §301.6402-1 and only the remainder, if any, of the overpayment will be offset by the amount of past-due support. However, an overpayment shall be offset by an amount of past-due support under section 6402(c) before any crediting of the overpayment to any future liability for an internal revenue tax. Thus, for example, if no outstanding tax liability is owed and the amount of an overpayment is equal to or less than the amount of past-due support, the Internal Revenue Service shall offset the overpayment by the amount of past-due support before crediting the overpayment against the taxpayer's estimated income tax for the succeeding taxable year under section 6402(b).

(2) *Amounts subject to offset.* The balance of any overpayment remaining after a crediting of the overpayment under section 6402(a) to any outstanding liability for tax on the part of the taxpayer shall be offset by the amount of past-due support of which the Internal Revenue Service has been notified under this section.

(3) *Amounts not subject to offset.* The amount of an overpayment not subject to offset for any liability for tax or for past-due support shall be promptly refunded to the taxpayer.

(e) *Notice of offset.* The Internal Revenue Service shall notify the taxpayer in writing of the amount and date of the offset for past-due support and of the State to which this amount of past-due support has been paid.

(f) *Disposition of amounts collected.* Amounts collected under this section shall be transferred to a special account maintained by the Bureau of Government Financial Operations. The Internal Revenue Service shall advise the Secretary of Health and Human Services or his delegate on a monthly basis of the names and social security numbers of the taxpayers from whom the amounts of past-due support were collected, of the amounts collected from each taxpayer, and of the State on whose behalf each collection was made. After authorization by the Division of Finance of the Social Security Administration, the Bureau of Government Financial Operations of the Department of the Treasury shall pay to the participating States amounts equal to the amounts collected under this section.

(g) *Fee.* A refund offset fee in the amount of $17.00 per offset for taxable year 1981, or such greater or smaller amount as the Secretary of the Treasury and the Secretary of Health and Human Services have agreed to be sufficient to reimburse the Internal Revenue Service for the full cost of the offset procedure, shall be billed and collected from the participating States by the Secretary of Health and Human Services or his delegate and deposited in the United States Treasury and credited to the appropriation accounts of the Internal Revenue Service which bore all or part of the costs involved in making the collection.

There is need for immediate guidance with respect to the provisions contained in this Treasury decision because the States must submit notifications of liability for past-due support to the Department of Health and Human Services by October 1, 1981. For this reason, it is found impracticable to issue it with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805) and section 2331(a) of the Omnibus Budget Reconciliation Act of 1981 (95 Stat. 357), amending section 464(a) of the Social Security Act (88 Stat. 2351).

JOSEPH T. DAVIS,
Acting Commissioner of Internal Revenue.

Approved November 9, 1981.

JOHN E. CHAPOTON,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on February 3, 1982, 5:02 p.m., and published in the issue of the Federal Register for February 8, 1982, 47 F.R. 5712)

Subchapter B.—Rules of Special Application

Section 6413.—Special Rules Applicable to Certain Employment Taxes

26 CFR 31.6413(a)-1: Repayment by employer of tax erroneously collected from employee. (Also Section 3402; 31.3402(f)(2)-1.)

Withholding; refunds and credits;

repayment or reimbursement. An employer may not repay or reimburse an employee for income taxes withheld during the year merely because the employee furnishes a new Form W-4 to the employer claiming additional exemptions or exemption from withholding.

Rev. Rul. 82-84

ISSUE

Under the circumstances described below may an employer repay or reimburse an employee for income taxes collected during the year when the employee furnishes a new withholding exemption certificate to the employer?

FACTS

Situation 1. At the beginning of 1981, *A*, a married individual, had in effect with employer *X* a Form W-4, Employee's Withholding Allowance Certificate, claiming married status and four withholding exemptions. *X* withheld the proper amount pursuant to the certificate. On August 24, 1981, *A* furnished *X* a new Form W-4 claiming married marital status and nine withholding exemptions. *A* requested that *X* repay or reimburse *A* the difference between the amount withheld by *X* in 1981 pursuant to *A*'s original Form W-4 and the amount that would have been withheld had the new W-4 been in effect the entire year.

Situation 2. B, a single individual, had in effect with employer *Y* a Form W-4 claiming single filing status and one withholding exemption. *Y* withheld the proper amount pursuant to the certificate. On August 24, 1981, *B* furnished *Y* a new Form W-4 claiming exemption from withholding. *B* requested that *Y* repay or reimburse *B* the entire amount withheld by *Y* in 1981.

Situation 3. C, a single individual, had in effect with employer *Z* a Form W-4 claiming single marital status and one withholding exemption. *Z* withheld the proper amount pursuant to the certificate. On August 24, 1981, *C* furnished a new Form W-4 to *Z* claiming married marital status and six withholding exemptions. *Z* failed to take the new Form W-4 into account and continued to withhold at the old rate. On October 26, 1981, *C* requested that *Z* repay or reimburse *C* the difference between the total amount withheld by *Z* in 1981 pursuant to *C*'s original Form W-4 and the amount that would have been withheld had the new Form W-4 been in effect for the entire year.

LAW AND ANALYSIS

Section 3402(a)(1) of the Internal Revenue Code requires that employers deduct and withhold tax from wages paid. Under section 3402(a)(2), the amount to be withheld is determined, in part, by the number of withholding exemptions claimed by the employee.

Section 3402(f)(2)(B) of the Code provides that if an employee is entitled to claim more withholding exemptions that are currently being claimed, the employee may furnish the employer with a new withholding exemption certificate claiming the number of exemptions that the employee is entitled to.

Section 3402(f)(3)(B) of the Code provides that a new withholding exemption certificate furnished the employer when a previous certificate is in effect will take effect for the first wage payment made on or after the first status determination date (January 1, May 1, July 1, or October 1) that occurs at least 30 days from the date on which the certificate is furnished, or, at the election of the employer, for any wage payment made on or after the date on which the certificate is furnished.

Under section 3402(f)(4) of the Code, withholding exemption certificates in effect generally remain in effect until another certificate takes effect. However, if the Internal Revenue Service notifies the employer that an employee's certificate is defective under section 31.3402(f)(2)-1(g)(5) of the Employment Tax Regulations the employer must disregard the certificate the employee filed and must withhold in accordance with the Service's instructions.

Section 6413(a)(1) of the Code provides that if more than the correct amount of tax under section 3402 is paid for any payment of remuneration, proper adjustments shall be made, without interest, as prescribed by regulations.

Section 31.6413(a)-1(a)(2) of the regulations provides that if an employer withholds more than the correct amount of income tax during any quarter, and repays the amount of the overcollection to the employee before the return for that quarter is filed and before the end of the year in which the overcollection was made, the employer need not report on any return or pay to the Internal Revenue Service the amount of the overcollection.

Similarly, section 31.6413(a)-1(b)(2) of the regulations provides that if an employer withholds more than the correct amount of income tax and has already paid the amount of the overcollection to the Service, the employer may repay or reimburse the employee in that amount in any subsequent return in that calendar year.

An adjustment under section 6413 of the Code may only be made if more than the *correct amount of tax* is withheld under section 3402 by the employer. The *correct amount of tax* under section 3402 is the amount required to be withheld based on the number of exemptions claimed on the withholding exemption certificate in effect at the time. Thus, in *Situations 1* and *2*, the employer withheld the correct amount of tax under section 3402. In neither situation was there an overcollection that could be repaid or reimbursed to the employee.

In *Situation 3*, the Form W-4 in effect on August 24, 1981, the date *C* furnished *Z* a new Form W-4, remained in effect until October 1, 1981, although *Z* could have elected to reduce *C*'s withholding on or after August 24, 1981. However, on or after the effective date of the new Form W-4, any amount withheld by *Z* in excess of the amount required to be withheld by the new Form W-4 was more than the correct amount of tax withheld. Thus, there was an overcollection that could be repaid or reimbursed to the employee. The amount withheld by *Z* before the effective date of the new Form W-4, however, was the correct amount of tax. Accordingly, none of that amount could be repaid or reimbursed.

HOLDING

If an employee furnishes a new withholding exemption certificate to an employer, the employer may not repay or reimburse the employee for income taxes collected during the year before the effective date of the new certificate. The employer may, however, repay or reimburse the employee for income taxes overcollected on or after the effective date if the employer failed to take the new certificate into account.

Section 6416.—Certain Taxes on Sales and Services

26 CFR 48.6416(a)-1: Refund or credit of tax under chapter 31 or 32.
(Also Sections 4081, 4083; 48.4081-1, 48.4083-1.)

Gasoline; credit or refund; wholesale distributor. A registered wholesale distributor who purchases tax-paid gasoline and then sells it at a tax-excluded price is not entitled to a credit or refund of the tax paid on the taxable sale of the gasoline.

Rev. Rul. 82-53

ISSUE

Is a refund of manufacturers excise tax available to a wholesale distributor of gasoline who sells tax-paid gasoline to another distributor at a price that does not include the tax paid?

FACTS

X, a registered wholesale distributor of gasoline, purchased gasoline from *Y*, who had previously purchased it from a refiner in a sale subject to the manufacturers excise tax imposed by section 4081(a) of the Internal Revenue Code. *Y*'s price to *X* included an amount equal to the federal excise tax paid by the refiner in its sale to *Y*. *X*, for competitive reasons, then sold the gasoline to another registered wholesale distributor at a price that did not include the tax paid by the refiner. *X* then filed a claim for a refund of the excise tax passed on by the refiner through *Y* to *X*.

LAW AND ANALYSIS

Section 4081 of the Code imposes a tax on the sale of gasoline by the producer or importer. This tax is to be paid by the producer or importer making the sale of the gasoline. Under section 4082, the term "producer" includes "wholesale distributor."

Section 4083 of the Code provides that gasoline may be sold tax free by a producer or importer of gasoline to other producers of gasoline. Under section 48.4083-1(a) of the Manufacturers and Retailers Excise Tax Regulations, both the buyer and seller must be registered in order for the gasoline to be sold tax free.

Section 6416(a)(1) of the Code provides that a refund or credit of any overpayment of manufacturers excise tax is allowed only if the *person who paid the tax* has not included the tax in the price of the article sold, has repaid the amount of the tax to the ultimate purchaser of the gasoline, or has the written consent of the ultimate purchaser to the allowance of the refund or credit.

Under section 6416 of the Code, only a person who paid the tax on the sale of the gasoline, and not a purchaser to whom the amount of tax is passed on, is entitled to a credit or refund, and then only if the conditions to allowance have been satisfied.

HOLDING

A refund of manufacturers excise tax is not available to a wholesale distributor who sells tax-paid gasoline to another distributor at a price that does not include the tax paid. Similarly, the wholesale distributor is not allowed the credit on its return provided by section 6416(f) of the Code.

In addition, the refiner who actually paid the tax to the government is not entitled to a credit or refund in this situation because there was no subsequent resale or use of the gasoline under section 6416(b)(2) that would give rise to an overpayment.

---

26 CFR 48.6416(b)-2: Tax payments deemed to be overpayments by reason of certain sales, or resales.

Whether the donation of a taxable article by a parent-teachers association to a state operate school will establish a basis for a credit or refun of the tax paid on such article. See Rev. Rul. 82 31, page 166.

---

26 CFR 48.6416(b)-3: Article sold tax-paid b manufacturer thereof to another manufacture for specified use.
(Also Sections 4061, 4221; 48.4061(b)-1, 48.4221-2.)

Manufacturers; parts and accessories; further manufacturer; credits or refund. A manufacturer of a part or accessory subject to tax may not claim a credit or refund of tax when the manufacturer sells the article tax-paid and a subsequent purchaser uses it in further manufacture. Only the person who uses the article in further manufacture is entitled to claim the credit or refund.

Rev. Rul. 82-14

ISSUE

Who may properly claim a credit or refund of tax imposed by section 4061(b)(1) of the Internal Revenue Code in the situation described below?

FACTS

X, a manufacturer of automotive parts and accessories, sold a part tax-paid to *Y*, who resold the part to *Z* for use as a component in the manufacture of another article. At the time of the sale *Z* informed *Y* that the part or accessory was to be used in the manufacture of another article. *Y* therefore reduced the price to *Z* by the amount of the tax paid on the original sale by *X*. *Y* then requested an adjustment from *X* to reflect the tax-excluded sale. *X*, in turn, claimed a credit in the amount of the tax on its quarterly excise tax return.

LAW AND ANALYSIS

Section 4061(b) of the Code imposes a manufacturers excise tax on certain automotive parts and accessories. Section 4221 provides rules under which parts and accessories may be sold tax free by the manufacturer. Under section 4221(a) a sale by a manufacturer may be made tax free if the article is for use by the purchaser, or for resale by the purchaser for use by the second purchaser, in the manufacture or production of another article.

Section 6416(b)(3)(B) of the Code provides rules for a credit or refund when a part or accessory sold by the manufacturer in a tax-paid transaction is used by a subsequent manufacturer in the manufacture or production of another article. Under that section the subsequent manufacturer is deemed to have made an overpayment of tax and may claim a credit or refund in the amount of the tax paid on the original manufacturer's sale of the article.

Section 6416(b)(3) of the Code provides the only method of obtaining a credit or refund of tax on a tax-paid article used in further manufacture. Only the subsequent manufacturer is entitled to file a claim. When parts or accessories are sold tax paid and later resold for use in the manufacture of another article, it is not appropriate for a dealer or distributor to remove the amount of tax from its selling price to the subsequent manufacturer with the expectation that the original manufacturer will make an adjustment in the form of a refund or credit of the amount of tax it passed on to the dealer or distributor.

HOLDING

When a manufacturer sells a taxable part or accessory tax-paid to a purchaser who resells the article for use in the manufacture or production of another article, only the subsequent manufacturer or producer may properly claim a credit or refund of the tax paid by the original manufacturer. Therefore, *X* is not entitled to a credit or refund in the situation described above.

For examples of how to compute the credit or refund, see Rev. Rul. 71-170, 1971-1 C.B. 365, and Rev. Rul. 73-560, 1973-2 C.B. 350.

Section 6424.—Lubricating Oil Used for Certain Nontaxable Purposes

(Also Section 4091; 26 CFR 48.4091-1.)

Lubricating oil; qualified business use; highway vehicles. The payment provided in section 6424 of the Code is not available to the ultimate purchaser of lubricating oil that is used in a highway vehicle for business purposes.

Rev. Rul. 82-77

ISSUE

Is the payment provided by section 6424 of the Internal Revenue Code available to the ultimate purchaser of lubricating oil that is used as such in a highway vehicle in its trade or business?

FACTS

X Corporation purchased from a dealer lubricating oil on which the federal manufacturers excise tax had been paid, and put the oil in the crankcase of a truck it used in its delivery business. *X* subsequently took a credit on its federal income tax return in the amount of the federal excise tax paid on the manufacturer's sale of the oil, citing the provisions of section 6424 of the Code as authority for the credit.

LAW AND ANALYSIS

Section 4091 of the Code imposes a 6 cents a gallon manufacturers excise tax on lubricating oil (other than cutting oils). Under section 6424, as amended by the Energy Tax Act of 1978, section 233(b), 1978-3 (Vol. 2) C.B. 1, 17, if lubricating oil (other than cutting oil or used oil) is used in a qualified business use, as defined in section 6421(d)(2), the Secretary shall pay to the ultimate purchaser of the oil an amount equal to 6 cents a gallon for each gallon of lubricating oil so used.

Under section 6421(d)(2) of the Code, the term "qualified business use" includes any use by a person in a trade or business other than as a fuel in a registered highway vehicle.

Because lubricating oil is not used as a fuel, sections 6421 and 6424 could be read to allow a credit or refund of an amount equal to the manufacturers excise tax for any tax paid oil used in a highway vehicle used for business purposes. However, the legislative history of the Energy Tax Act of 1978 indicates that the Act merely limited the then-existing credit or refund available for all non-highway uses of lubricating oil to only business related non-highway use. See S. Rept. No. 95-1324, 95th Cong., 2d Sess. (1978), 1978-3 (Vol. 2) C.B. 309, 322.

HOLDING

The payment provided by section 6424 of the Code is not available to the ultimate purchaser of lubricating oil that is used as such in a highway vehicle in its trade or business.

Chapter 66.—Limitations
Subchapter A.—Limitations on Assessment and Collection

Section 6501.—Limitations on Assessment and Collection

26 CFR 301.6501(c)-1: Exceptions to general period of limitations on assessment and collection.

Conditions under which a less than wholly subsidiary may be included in a multiple consent to extend the period of limitations for assessment. See Rev. Proc. 82-6, page 409.

Subchapter B.—Limitations on Credit or Refund

Section 6511.—Limitations on Credit or Refund

26 CFR. 301.6511(b)-1: Limitations on allowance of credits and refunds.

Whether investment tax credit on qualified section 38 property must have been claimed on an income tax return or in a timely claim for refund for the year the property was placed in service before the investment tax credit can be carried over to a succeeding tax year. See Rev. Rul. 82-49, page 5.

---

26 CFR 301.6511(c)-1: Special rules applicable in case of extension of time by agreement.

Conditions under which a less than wholly owned subsidiary may be included in a multiple consent to extend the period of limitations for assessment. See Rev. Proc. 82-6, page 409.

Chapter 67.—Interest
Subchapter A.—Interest on Underpayments

Section 6601.—Interest on Underpayment, Nonpayment, or Extensions of Time for Payment of Tax

26 CFR 301.6601-1: Interest on underpayments.
(Also Sections 6081, 6152, 6164; 1.6081-3; 1.6152-1, 1.6164-1.)

Deficiencies; interest; installment privilege elected; net operating loss anticipated. When a corporation elects to pay its taxes in installments under section 6152 of the Code and also extends the period for payment because of an expected net operating loss under section 6164, interest runs on the amount deferred under section 6164 from the original due date only on that amount not deferred under section 6152. Interest runs from the due date of the second installment on the remaining portion of the amount subject to the section 6164 election.

Rev. Rul. 82-48

ISSUE

If the time for payment of corporate income tax is extended under section 6164 of the Internal Revenue Code, from what date or dates does interest accrue on the unpaid tax if the taxpayer applied for an automatic extension of time to file a corporate income tax return and paid with the application the entire difference between the unpaid tentative tax reported and the amount of tax for which payment was extended under section 6164?

FACTS

On March 15, 1980, *X* corporation timely filed a Form 7004, Application for Automatic Extension of Time to File Corporation Income Tax Return, for the tax year ending December 31, 1979. The Form 7004 showed a tentative tax liability of $1,500,000, a $200,000 estimated tax credit, and an unpaid amount of $1,300,000. On March 15, 1980, *X* also deferred payment of $1,000,000 of the $1,300,000 by simultaneously filing Form 1138, Extension of Time for Payment of Taxes by Corporation Expecting a Net Operating Loss Carryback. *X* paid the balance of $300,000 when it filed Forms 7004 and 1138.

On June 15, 1980, *X* filed Form 7005, Application for Additional Extension of Time to File Corporation Income Tax Return. On September 15, 1980, *X* filed Form 1120, U.S. Corporation Income Tax Return, for the year ending December 31, 1979, which reported a tax liability of $1,500,000. On March 15, 1981, *X* filed Form 1120 for the year ending December 31, 1980, and Form 1139, Corporation Application for Tentative Refund. *X* reported a net operating loss for the year ending December 31, 1980, which resulted in $1,000,000 tax decrease for the previous year.

LAW AND ANALYSIS

Section 6081(b) of the Code provide an automatic 3-month extension of time in which a corporation may file its income tax return (Form 1120), if it files the correct form prescribed (Form 7004) and timely pays the amount properly estimated as its tax or the first installment required under section 6152.

Section 6152(a) of the Code provides that a corporation may elect to pay the unpaid amount of income tax in two equal installments.

Section 6152(b)(2) of the Code provides that in any case in which the tax may be paid in two installments, the first installment must be paid on the date prescribed for the payment of tax and the second installment must be paid within 3 months after that date.

Section 1.6152-1(a)(2) of the Income Tax Regulations provides that a corporation is considered to have made an election to pay its tax in installments if it files a Form 7004 and pays 50 percent of the amount of the tax shown as unpaid with that form.

Section 6164(a) of the Code provides that if a corporation files a statement (Form 1138) for an expected net operating loss carryback for the current tax year, the time for payment of all or part of any income tax for the immediately preceding tax year will be extended. Under section 6164(c), the amount for which payment may be extended under section 6164(a) may not exceed the amount of tax shown on the return.

Section 6601(a) of the Code provides that if any amount of tax is not paid timely, interest on that amount must be paid at the annual rate established under section 6621 from the last date prescribed for payment to the date paid.

Section 6601(b)(2) of the Code provides that, for purposes of section 6601(a), when an election has been made under section 6152(a) to pay tax in installments, the last date prescribed for payment of any tax shown on the taxpayer's return is the date prescribed for payment of each installment as determined under section 6152(b).

Section 6601(d) of the Code provides that if the amount of any tax is reduced because of a carryback of a net operating loss, the reduction in tax does not affect the computation of interest for the period ending with the last day of the tax year in which the net operating loss arises.

Section 301.6601-1(e)(2) of the Regulations on Procedure and Administration provides that when an extension of time for payment of income tax has been granted under section 6164 of the Code, interest is due on the amount of the unpaid tax from the last date prescribed for payment without regard to the extension.

Rev. Rul. 56-668, 1956-2 C.B. 961, holds that unpaid original tax, for the year being adjusted, which is not to be collected because of a net operating loss carryback, will be abated. Interest on this amount will be charged (whether or not payment was deferred under the provisions of section 6164 of the Code) from the due date of the tax, or the respective due dates of the unpaid installments, to the last day of the loss year.

Rev. Rul. 82-47, page 201, this Bulletin, holds that elections under section 6152(a) of the Code are valid if they are made without an accompanying payment as long as the expected carryback adjustment will eliminate 50 percent or more of the tentative tax shown on Form 7004. In other cases, the corporation must pay with Form 7004 the difference between 50 percent of the amount shown on Form 7004 and the amount of the expected carryback adjustment.

Thus, *X* properly elected under section 6152(a) of the Code to make installment payments of the entire amount shown on its Form 7004 as unpaid tentative tax ($1,300,000). The first installment of 50 percent of that amount ($650,000), which was due with the Form 7004, was satisfied in part by the $300,000 payment. Payment of the remaining $350,000 of that installment was deferred under section 6164. Payment of the entire second installment was also deferred under section 6164. The amount of the second installment (650,000) equals the balance of the $1,000,000 tax liability for which an extension of time for payment was sought.

HOLDING

Interest is computed under section 6601(a) of the Code on $350,000 of *X*'s $1,000,000 unpaid tax liability ($1,500,000 tax liability less $200,000 of estimated tax payments and $300,000 paid with Form 7004) from the return due date of March 15, 1980, until December 31, 1980, the last day of the loss year. The $350,000 is the nondeferred portion of the first installment. Interest is computed on the remaining $650,000 from June 15, 1980, the due date of the second installment, until December 31, 1980.

26 CFR 301.6601-1: Interest on underpayments.

Employers in New Hampshire who claimed federal unemployment tax credits for 1978. See Rev. Proc. 82-34, page 489.

Chapter 68.—Additions to the Tax, Additional Amounts, and Assessable Penalties

Subchapter A.—Additions to the Tax and Additional Amounts

Section 6651.—Failure to File Tax Return or to Pay Tax

26 CFR 301.6651-1: Failure to file tax return or to pay tax.

Contractors and subcontractors subject to the Vinson-Trammel Act are advised of the repeal of the requirement to file Forms 949 and 949-A. See Rev. Proc. 82-24, page 474.

Section 6654.—Failure By Individual To Pay Estimated Income Tax

26 CFR 1.6654-2: Exceptions to imposition of the addition to the tax in the case of individuals.

For purposes of section 6655(d)(2) of the Code, relating to the exception to the addition to the tax for a corporation, does an increase in the percentage imposed by section 46(a)(3)(B) of the Code, limiting the amount of the investment credit allowed under section 38 of the Code constitute a change in rates within the meaning of section 1.6655-2(b)(2)(ii) of the Regulations? See Rev. Rul. 82-65, below.

Section 6655.—Failure By Corporation To Pay Estimated Income Tax

26 CFR 1.6655-2: Exception to imposition of the addition to the tax in the case of corporations.
(Also Sections 38, 46, 6654; 1.38-1, 1.46-1, 1.6654-2.)

Estimated tax; exceptions to avoid penalty; investment credit limitation. The increase in the limitation for investment credit imposed by section 46(a)(3)(B) of the Code is a change in rates within the meaning of section 1.6655-2(b)(2)(ii) of the regulations. A taxpayer may recompute the limitation imposed on the investment credit for purposes of reducing the tax liability and the amount of the estimated tax payment needed to avoid the estimated tax payment.

Rev Rul. 82-65

ISSUE

Does an increase in the percentage imposed by section 46(a)(3)(B) of the Internal Revenue Code, limiting the amount of investment credit allowed under section 38, constitute a change in rates within the meaning of section 1.6655-2(b)(2)(ii) of the Income Tax Regulations for purposes of the exception to the addition to the tax for underpayment of estimated tax by a corporation?

FACTS

The taxpayer corporation underpaid estimated tax for the taxable year 1980 and claimed relief from the penalty for underpayment under the exception provided by section 6655(d)(2) of the Code. The amount of the investment credit allowed by section 38 on the taxpayer's 1979 Form 1120, U.S. Corporation Income Tax Return, was reduced because of the limitation imposed by section 46(a)(3)(B). The taxpayer recomputed the limitation imposed on the investment credit during 1979 using 1980's increased percentage limitation, thus reducing the tax liability and the amount of the 1980 estimated tax payment needed to avoid the estimated tax penalty.

LAW AND ANALYSIS

Section 38 of the Code provides for a credit against income tax for qualified investments in certain properties.

Section 46(a)(2) of the Code provides that the amount of the investment credit for the taxable year shall be an amount equal to the sum of certain specified percentages of the qualified investment.

Section 46(a)(3) of the Code provides that the credit allowed by section 38 for the taxable year shall not exceed the first $25,000 of the tax liability plus a specified percentage of the liability for the tax over $25,000. The specified percentage increases each year from 1979 through 1982.

Section 6655(a) of the Code provides that in the case of any underpayment of estimated tax by a corporation, except as provided in section 6655(d), there shall be added to the tax for the taxable year an amount determined at an annual rate established under section 6621 upon the underpayment for the period of the underpayment.

Section 6655(d)(2) of the Code provides that the addition to the tax with respect to any underpayment of any installment shall not be imposed if the total amount of all payments of estimated tax made on or before the last date prescribed for the payment of such installment equals or exceeds the amount that would have been required to be paid on or before such date if the estimated tax were on an amount equal to the tax computed at the rates applicable to the taxable year, but otherwise on the basis of the facts shown on the return of the corporation for, and the law applicable to, the preceding taxable year.

Section 1.6655-2(b)(2)(ii) of the regulations provides that the credits against the tax allowed by sections 32, 33, and 38 of the Code are such credits shown on the return for the preceding taxable year, except that if the amount of any such credit would be affected by any change in rates, the credits shall be determined by reference to the rates applicable to the current taxable year.

The regulations under section 6655 of the Code do not deal with what constitutes a change in rate in relation to the investment tax credit. However, Rev. Rul. 72-91, 1972-1 C.B. 400, which holds that the termination of the investment credit by section 49 of the Code is a change in the rate, provides that, for purposes of section 6655(d)(2), reference should be made to the regulations under section 6654(d)(4), relating to individuals.

Under section 1.6654-2(b)(2) of the regulations, a change in rate may be either a change in the rate of tax or a change in a percentage affecting the computation of a credit, such as change in the percentage of the qualified investment which is specified by section 46 of the Code for use in determining the amount of the investment credit allowed by section 38.

The investment credit under section 38 of the Code is computed by first applying the percentage rate specified in section 46(a)(2) to the amount of the qualified investment and then determining whether the amount of the credit is within the limitation imposed by section 46(a)(3)(B). Thus, a change in this limitation percentage directly affects the computation of the investment credit, as did the change in rate in Rev. Rul. 72-91.

HOLDING

An increase in the percentage imposed by section 46(a)(3)(B) of the Code is a change in rates within the meaning of section 1.6655-2(b)(2)(ii) of the regulations; thus, a taxpayer may recompute the limitation imposed on the investment credit during 1979 by using 1980's increased percentage limitation for purposes of reducing the tax liability and the amount of the 1980 estimated tax payment needed to avoid the estimated tax penalty.

Section 6659.—Addition to Tax in the Case of Valuation Overstatements for Purposes of the Income Tax

Penalties; valuation overstatements; partnerships. The addition to tax for valuation overstatements under section 6659 of the Code applies to individual partners when the overstatement is made by the partnership on the partnership return.

Rev. Rul. 82-37

ISSUE

Does the addition to tax for valuation overstatements under section 6659 of the Internal Revenue Code apply to individual partners when the overstatement is made on the partnership return?

LAW AND ANALYSIS

Section 6659 of the Code, as enacted by the Economic Recovery Tax Act of 1981, section 722(a), Pub. L. 97-34, 1981-2 C.B. 256, 344, provides for an addition to tax for underpayments attributable to valuation overstatements claimed on any return. The addition to tax is applicable to individuals, closely held corporations, and personal service corporations, and is effective for returns filed after December 31, 1981.

An underpayment of an individual's income tax because of an understatement on the individual's return of the individual's distributive share of partnership income (or overstatement of distributive share of partnership loss) attributable to a valuation overstatement by the partnership on the partnership return is an underpayment of income tax attributable to a valuation overstatement.

HOLDING

The addition to tax for valuation overstatements under section 6659 of the Code applies to individual partners when the overstatement is made by the partnership on the partnership return.

Subchapter B.—Assessable Penalties

Section 6692.—Failure to File Actuarial Report

26 CFR 301.6692-1: Failure to file actuarial report.

Periodic actuarial reports filed for defined benefit pension plans. See T.D. 7798, page 197.

Section 6694.—Understatement of Taxpayer's Liability by Income Tax Return Preparer

26 CFR 1.6694-1: Understatement of taxpayer's liability by income tax return preparer.

Penalties; income tax return preparers; carrybacks. Preparer penalties will not be abated if the taxpayer's liability is eliminated or not assessed because of a net operating loss carryback. Preparer penalties will be abated if a taxpayer's liability is abated because of an unclaimed item arising in the same year.

Rev. Rul. 82-25

ISSUES

1. Will a preparer penalty under section 6694(a) of the Internal Revenue Code be abated if a taxpayer's liability is eliminated by a net operating loss carryback?

2. May a preparer penalty under section 6694(a) of the Code be assessed if no deficiency is assessed because of the application of a carryback?

3. Will a preparer penalty under section 6694(a) of the Code be abate if a deficiency is eliminated because o an offsetting adjustment arising in th same tax year?

FACTS

Situation 1. *B*, an income tax retur preparer, negligently overstated *A'* expenses on *A*'s 1978 federal incom tax return. The Internal Revenu Service examined the return and as sessed a deficiency against *A*. *A* agree to the assessment and paid the ta due. The Service also assessed a penal ty against *B* under section 6694(a) o the Code. In 1980, *A* incurred a ne operating loss. *A* filed claims for re fund carrying back the loss to 1977 1978, and 1979, eliminating all ta due for those years. The Service exam ined the claims, determined they wer correct, and allowed the refunds.

Situation 2. Same as above, excep the Service did not examine *A*'s 197 return until the refund claims wer filed. An examination of all four year disclosed that the net operating loss fo 1980 was correctly computed but tha the tax shown on *A*'s original 1978 r turn was understated due to *B*'s negl gence. The potential deficiency due from *A* was not assessed because of the carryback, although interest was properly assessed against *A* from April 15, 1979, to December 31, 1980.

Situation 3. B negligently overstated some of *A*'s expenses on *A*'s 1978 return but also negligently failed to claim other deductions for a greater amount that *A* was entitled to. The Service examined *A*'s 1978 return and disallowed the negligently overstated expenses, resulting in a deficiency which *A* agreed to and paid. The Service also assessed a penalty under section 6694(a) of the Code against *B*. *A* later discovered the other deductions not taken and filed a claim for refund. The Service examined the claim, determined that it was correct, and refunded the overpayment to *A*.

LAW AND ANALYSIS

Section 6694(a) of the Code provides that if any part of any understatement of liability for any return or claim for refund is due to the negligent or intentional disregard of rules and regulations by a person who is an income tax return preparer with respect to that return, the preparer must pay a penalty of $100 with respect to that return.

Section 6694(d) of the Code provides that the penalty will be abated if at any time there is a final administrative determination or judicial decision that there was no understatement of liability with respect to a return or claim for refund for which a penalty under section 6694(a) has been assessed.

Section 6694(e) of the Code defines "understatement of liability" as any understatement of the net amount payable or any overstatement of the net amount creditable or refundable with respect to any tax imposed by subtitle A.

Rev. Rul. 72-484, 1972-2 C.B. 638, holds that penalties under section 6651(a) of the Code may not be refunded if a net operating loss carryback results in a refund of the tax paid.

The applicable rules in section 6694 of the Code do not require that tax actually be assessed against a taxpayer in order for a penalty to be assessed against the preparer. Section 6694(d) merely requires that any penalty that is assessed must be abated if it is determined that there was no understatement of liability on the underlying return. In *Situation 1* and *2*, *B*'s negligence resulted in an understatement of *A*'s liability on *A*'s 1978 return. While the tax due from *A* in *Situation 1* was later eliminated, there was no final administrative determination that there was no understatement of liability relating to the return. Similarly, in *Situation 2*, the failure to make an assessment against *A* was not due to a determination that the return prepared by *B* did not understate *A*'s liability. The crucial element in these situations is not whether *A* owed tax after carryback adjustments were made to the total liability but whether the return, when filed, showed an understatement of the tax due. Thus, in *Situation 3*, there was no understatement of liability on *A*'s return because the total liability that should have been shown by *B* in preparing the return was less than the amount actually shown.

HOLDINGS

1. The penalty under section 6694(a) of the Code will not be abated if the taxpayer's liability is eliminated by a net operating loss carryback.
2. The penalty under section 6694(a) of the Code may be assessed if no underlying deficiency is assessed because of the application of a carryback.
3. The penalty under section 6694(a) of the Code will be abated if a deficiency is abated because of an offsetting adjustment arising in the same tax year.

Chapter 80.—General Rules
Subchapter A.—Applications of Internal Revenue Laws

Section 7805—Rules and Regulations

26 CFR 301.7805-1: Rules and regulations.

Rev. Rul. 82-127

ISSUE

Periodically, the Internal Revenue Service has obsoleted revenue rulings which, although not specifically revoked or superseded, are not considered determinative with respect to future transactions because (1) the applicable statutory provisions have been changed or repealed; (2) the ruling position is specifically covered by statute, regulations, or a subsequent published position; or (3) the facts set forth no longer exist or are not sufficient to permit application of the current statute.

The revenue rulings listed below are hereby declared to be obsolete:

Rev. Rul.	*No.*
54-27	1954-1 C.B. 44
54-92	1954-1 C.B. 207
54-190	1954-1 C.B. 46

The purpose of this declaration of obsoleteness is to make clear to all concerned that the above listed revenue rulings are not determinative with respect to future transactions. It is not the purpose of this revenue ruling to determine their applicability to past transactions.

---

26 CFR 301.7805-1: Rules and regulations.

Nonretroactive application of ruling holding nonprofit community action organization does not come within the scope of federal excise tax exemptions for states and local governments. See Rev. Rul. 82-30, page 165.

---

26 CFR 301.7805-1: Rules and regulations.

Prospective application of a revenue ruling revoking Rev. Rul. 65-59, dealing with "scholarships" and "fellowships." See Rev. Rul. 82-57, page 24.

---

26 CFR 301.7805-1: Rules and regulations.

Nonretroactive application of revenue ruling relating to the requirements that the purchase of an annuity contract under section 403(b)(1) of the Code must be funded through insurance. See Rev. Rul. 82-102, page 62.

---

26 CFR 301.7805-1: Rules and regulations.

Claims for refund of the highway use tax paid for periods prior to July 1, 1981, by Canadian truckers described in Rev. Rul. 81-86, 1981-1 C.B. 504. See Rev. Rul. 82-126, page 204.

[illegible]

[illegible]

[illegible]

Part II. Treaties and Tax Legislation

CONTENTS

Subpart A.—Tax Conventions

United States-Arab Republic of Egypt
  Income Tax Convention 219
  Senate Executive Report No. 97-27 230
  Technical Explanation 243

United States-Jamaica Income Tax Convention 257
  Senate Executive Report No. 97-40 274
  Technical Explanation 291

Subpart B.—Legislation and Related Committee Reports

Public Law 97-21 (H.J. Res. 238) 305

Public Law 97-51 (H.J. Res. 325) 306

Public Law 97-92 (H.J. Res. 370) 306

Public Law 97-119 (H.R. 5159) 307
  House Report No. 97-406 Part 1 311

Public Law 97-123 (H.R. 4331) 314
  Conference Report No. 97-409 315

Public Law 97-164 (H.R. 4482) 316
  House Report No. 97-312 320

Part II. Treaties and Tax Legislation

Subpart A.—Tax Conventions

UNITED STATES-ARAB REPUBLIC OF EGYPT INCOME TAX CONVENTION [1]

Convention signed at Cairo August 24, 1980;

Ratification advised by the Senate of the United States of America November 18, 1981;

Ratified by the President of the United States of America December 1, 1981;

Ratified by the Arab Republic of Egypt;

Ratifications exchanged at Washington December 1, 1981;

Proclaimed by the President of the United States of America December 15, 1981;

Entered into force December 31, 1981.

BY THE PRESIDENT OF THE UNITED STATES OF AMERICA

A PROCLAMATION

CONSIDERING THAT:

The Convention between the Government of the United States of America and the Government of the Arab Republic of Egypt for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income was signed at Cairo on August 24, 1980, the text of which is hereto annexed;

The Senate of the United States of America by its resolution of November 18, 1981, two-thirds of the Senators present concurring therein, gave its advice and consent to ratification of the Convention, subject to the following:

1) understanding that appropriate Congressional committees and the General Accounting Office shall be afforded access to the information exchanged under this treaty where such access is necessary to carry out their oversight responsibilities, subject only to the limitations and procedures of the Internal Revenue Code.

2) reservation that notwithstanding the provisions of paragraph (3) of Article 7 of the Convention (which relates to the taxation of gains from the alienation of shares of a corporation or of an interest in a partnership, estate, or trust, the property of which consists, directly or indirectly, principally of real property situated in one of the countries), gain derived by a resident of a Contracting State, from the alienation or other disposition of an interest in a corporation, or an interest in a partnership, trust, or estate, which has an interest in real property located in the other Contracting State, or the assets of which are considered under domestic law of that other Contracting State to consist, in whole or in part, of real property, or an interest therein, in that other State, may be taxed by that other State to the extent provided for by its domestic law. In addition, gain derived by a corporation which is a resident of a Contracting State upon the distribution (including a distribution in liquidation or otherwise) of an interest in real property (as determined under the domestic law of the other Contracting State) may be taxed by that other Contracting State to the extent provided for by its domestic law.

The Convention was ratified, subject to the aforesaid understanding and reservation, by the President of the United States of America on December 1, 1981, in pursuance of the advice and consent of the Senate and was ratified on the part of the Arab Republic of Egypt;

The instruments of ratification of the Convention were exchanged at Washington on December 1, 1981, and accordingly the Convention enters into force on December 31, 1982, effective as specified in Article 31;

NOW, THEREFORE, I, Ronald Reagan, President of the United States of America, proclaim and make public the Convention to the end that it be observed and fulfilled with good faith on and after December 31, 1981, by the United States of America and by the citizens of the United States of America and all other persons subject to the jurisdiction thereof.

IN TESTIMONY WHEREOF, I have signed this proclamation and caused the Seal of the United States of America to be affixed.

DONE at the city of Washington this fifteenth day of December in the year of our Lord one thousand nine hundred eighty-one and of the Independence of the United States of America the two hundred sixth.

By the President:
RONALD REAGAN
ALEXANDER M. HAIG, JR.
Secretary of State

CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE ARAB REPUBLIC OF EGYPT FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME

The Government of the United States of America and the Government of the Arab Republic of Egypt, desiring to conclude a convention for the avoidance of double taxation of income, the prevention of fiscal evasion with respect to taxes on income, and the elimination of obstacles to international trade and investment;

Have agreed as follows:

ARTICLE 1

TAXES COVERED

(1) The taxes which are the subject of this Convention are:

(a) In the case of the United States, the Federal income taxes imposed by the Internal Revenue Code but excluding the accumulated earnings tax and the personal holding company tax, and

(b) In the case of Egypt:

(i) Tax on income derived from immovable property (including the land tax, the building tax, and the ghaffir tax);

(ii) Tax on income from movable capital;

---

[1] The text of the convention is contained in the pamphlet of the Treaties and Other International Act Series (TIAS) and is designated TIAS 10149. Pertinent excerpts from Senate Report No. 97-27, page 230; Treasury Department Technical Explanation, page 243; Senate Executive D is not published.

(iii) Tax on commercial and industrial profits;

(iv) Tax on wages, salaries, indemnities, and pensions;

(v) Tax on profits from liberal professions and all other noncommercial professions;

(vi) General income tax;

(vii) Defense tax;

(viii) National security tax;

(ix) War tax; and

(x) Supplementary taxes imposed as a percentage of taxes mentioned above.

(2) This Convention shall also apply to taxes substantially similar to those covered by paragraph (1) which are imposed in addition to, or in place of, existing taxes after the date of signature of this Convention.

(3) For the purpose of Article 26 (Nondiscrimination), this Convention shall also apply to taxes of every kind imposed at the national, state, or local level. For the purpose of Article 28 (Exchange of Information), this Convention shall also apply to taxes of every kind imposed at the national level.

(4) The competent authorities of the Contracting States shall notify each other promptly of any amendments of the tax laws referred to in paragraph (1) and of the adoption of any taxes referred to in paragraph (2) by transmitting the texts of any amendments or new statutes.

(5) The competent authorities of the Contracting States shall notify each other promptly of the publication by their respective Contracting States of any material concerning the application of this Convention, whether in the form of regulations, rulings, or judicial decisions, by transmitting the texts of any such materials.

ARTICLE 2

GENERAL DEFINITIONS

(1) In this Convention, unless the context otherwise requires:

(a)(i) The term "United States" means the United States of America; and

(ii) When used in a geographical sense, the term "United States" means the states thereof and the District of Columbia. Such term also includes:

(A) The territorial sea thereof, and

(B) The seabed and subsoil of the submarine areas adjacent to the coast thereof, but beyond the territorial sea, over which the United States exercises sovereign rights, in accordance with international law, for the purpose of exploration for and exploitation of the natural resources of such areas, but only to the extent that the person, property, or activity to which the Convention is being applied is connected with such exploration or exploitation.

(b)(i) The term "Egypt" means the Arab Republic of Egypt; and

(ii) When used in a geographical sense the term "Egypt" includes:

(A) The territorial sea thereof, and

(B) The seabed and subsoil of the submarine areas adjacent to the coast thereof, but beyond the territorial sea, over which Egypt exercises sovereign rights, in accordance with international law, for the purpose of exploration for and exploitation of the natural resources of such area, but only to the extent that the person, property, or activity to which this Convention is being applied is connected with such exploration or exploitation.

(c) The term "Contracting State" means the United States or Egypt, as the context requires.

(d) The term "State" means any national State, whether or not one of the Contracting States.

(e) The term "person" includes an individual, a partnership, a corporation, an estate, or a trust.

(f)(i) The term "United States corporation" means a corporation (or any unincorporated entity treated as a corporation for United States tax purposes) which is created or organized under the laws of the United States or any state thereof or the District of Columbia; and

(ii) The term "Egyptian corporation" means a corporation or any unincorporated entity treated as a corporation for Egyptian tax purposes which is created or organized under the laws of Egypt.

(g) The term "competent authority" means:

(i) In the case of the United States, the Secretary of the Treasury or his delegate, and

(ii) In the case of Egypt, the Minister of Finance or his delegate.

(h) The term "tax" means tax imposed by the United States or Egypt whichever is applicable, to which this Convention applies by virtue of Article 1 (Taxes Covered).

(i) The term "international traffic" means any voyage of a ship or aircraft operated by a resident of one of the Contracting States except where such voyage is confined solely to places within a Contracting State.

(2) Any other term used in this Convention and not defined in this Convention shall, unless the context otherwise requires, have the meaning which it has under the laws of the Contracting State whose tax is being determined. Notwithstanding the preceding sentence, if the meaning of such a term under the laws of one of the Contracting States is different from the meaning of the term under the laws of the other Contracting State, or if the meaning of such a term is not readily determinable under the laws of one of the Contracting States, the competent authorities of the Contracting States may, in order to prevent double taxation or to further any other purpose of this Convention, establish a common meaning of the term for the purpose of this Convention.

ARTICLE 3

FISCAL RESIDENCE

(1) In this Convention:

(a) The term "resident of Egypt" means:

(i) An Egyptian corporation, and

(ii) Any other person (except a corporation or an entity treated under Egyptian law as a corporation) resident in Egypt for purposes of Egyptian tax, but in the case of a partnership, estate, or trust only to the extent that the income derived by such partnership, estate, or trust is subject to Egyptian tax as the income of a resident either in the hands of the respective entity or of its partners or beneficiaries.

(b) The term "resident of the United States" means:

(i) A United States corporation, and

(ii) Any other person (except a corporation or any entity treated as a corporation for United States tax purposes) resident in the United States for purposes of United States tax, but in the case of a partnership, estate, or trust only to the extent that the income derived by such partnership, estate, or trust is subject to United States tax as the income of a resident either in the hands of the respective entity or of its partners or beneficiaries.

(2) Where by reason of the provisions of paragraph (1) an individual is a resident of both Contracting States, then his residence shall be determined in accordance with the following rules:

(a) He shall be deemed to be a resident of that Contracting State in which he maintains his permanent home. If he has a permanent home in both Contracting States or in neither of the Contracting States, he shall be deemed to be a resident of that Contracting State with which his personal and economic relations are closest (center of vital interests);

(b) If the Contracting State in which he has his center of vital interests cannot be determined, he shall be deemed to be a resident of that Contracting State in which he has an habitual abode;

(c) If he has an habitual abode in both Contracting States or in neither of the Contracting States, he shall be deemed to be a resident of the Contracting State of which he is a citizen; and

(d) If he is a citizen of both Contracting States or of neither Contracting State, the competent authorities of the Contracting States shall settle the question by mutual agreement.

ARTICLE 4

SOURCE OF INCOME

For purposes of this Convention:

(1) Dividends shall be treated as income from sources within a Contracting State only if paid by a corporation of that Contracting State. Notwithstanding the preceding sentence, a dividend shall be treated as from sources within—

(a) Egypt if paid by a United States corporation whose activities lie solely or mainly in Egypt and to which paragraph (5) of Article 11 (Dividends) applies.

(b) The United States if paid by a corporation other than a United States corporation if, for the 3-year period ending with the close of such corporation's taxable year preceding the declaration of the dividend (or for such part of that period as such corporation has been in existence), at least 50 percent of such corporations' gross income from all sources was industrial or commercial profits attributable to a permanent establishment which such corporation had in the United States.

(2) Interest shall be treated as income from sources within a Contracting State only if paid by such Contracting State, a political subdivision or a local authority thereof, or by a resident of that Contracting State. Notwithstanding the preceding sentence, if such interest is paid on an indebtedness incurred in connection with a permanent establishment which bears such interests, then such interest shall be deemed to be from sources within the State (whether or not a Contracting State) in which the permanent establishment is situated.

(3) Royalties described in paragraph (2) of Article 13 (Royalties) for the use of, or the right to use, property or rights described in such paragraph shall be treated as income from sources within a Contracting State only to the extent that such royalties are for the use of, or the right to use, such property or rights within that Contracting State.

(4) Income from real property (including royalties), described in Article 7 (Income from Real Property) shall be treated as income from sources within a Contracting State only if such property is situated in that Contracting State.

(5) Income from the rental of tangible personal (movable) property shall be treated as income from sources within a Contracting State only if such property is situated in that Contracting State.

(6) Income from the purchase and sale or exchange of intangible or tangible personal property (other than gains defined as royalties by paragraph (2) of Article 13 (Royalties)) shall be treated as income from sources within a Contracting State only if such sale or exchange is within that Contracting State.

(7) Income received by an individual for his performance of labor or personal services whether as an employee or in an independent capacity, shall be treated as income from sources within a Contracting State only to the extent that such services are performed in that Contracting State. Income from personal services performed aboard ships or aircraft operated by a resident of one of the Contracting States in international traffic shall be treated as income from sources within that Contracting State if rendered by a member of the regular complement of the ship or aircraft. Notwithstanding the preceding provisions of this paragraph, remuneration described in Article 21 (Governmental Functions) and payments described in Article 20 (Social Security Payments) paid from the public funds of a Contracting State or a political subdivision or local authority thereof shall be treated as income from sources within that Contracting State only.

(8) Notwithstanding paragraphs (1) through (6), industrial or commercial profits which are attributable to a permanent establishment which the recipient, a resident of one of the Contracting States, has in the other Contracting State shall be treated as income from sources within that other Contracting State. Industrial or commercial profits attributable to such permanent establishment include any item of income described in paragraphs (1) through (6) to the extent provided in paragraph (6) of Article 8 (Business Profits).

(9) The source of any item of income to which paragraphs (1) through (8) are not applicable shall be determined by each of the Contracting States in accordance with its own law. Notwithstanding the preceding sentence, if the source of any item of income under the laws of one Contracting State is different from the source of such item of income under the laws of the other Contracting State or if the source of such income is not readily determinable under the laws of one of the Contracting States, the competent authorities of the Contracting States may, in order to prevent double taxation or further any other purpose of this Convention, establish a common source of the item of income for purposes of this Convention.

ARTICLE 5

PERMANENT ESTABLISHMENT

(1) For the purpose of this Convention, the term "permanent establishment" means a fixed place of business through which a resident of one of the Contracting States engages in industrial or commercial activity.

(2) The term "permanent establishment" includes but is not limited to:

(a) A seat of management;

(b) A branch;

(c) An office;

(d) A factory;

(e) A workshop;

(f) A mine, quarry, or other place of extraction of natural resources; and

(g) The maintenance of a building site or construction or installation project which exists for more than 6 months.

(3) Notwithstanding paragraphs (1) and (2), a permanent establishment shall not include a fixed place of business used only for one or more of the following:

(a) The use of facilities for the purpose of storage, display, or delivery of goods or merchandise belonging to the resident;

(b) The maintenance of a stock of goods or merchandise belonging to the resident for the purpose of storage, display, or delivery;

(c) The maintenance of a stock of goods or merchandise belonging to the resident for the purpose of processing by another person;

(d) The maintenance of a fixed place of business for the purpose of purchasing goods or merchandise, or for collecting information, for the resident;

(e) The maintenance of a fixed place of business for the purpose of advertising, for the supply of information, for scientific research, or for similar activities which have a preparatory or auxiliary character, for the resident; and

(f) The maintenance of a building site or construction or installation project which does not exist for more than 6 months.

(4) A person acting in one of the Contracting States on behalf of a resident of the other Contracting State, other than an agent of an independent status to whom paragraph (5) applies, shall be deemed to give rise to a permanent establishment in the first-mentioned Contracting State if such person has, and habitually exercises in the first-mentioned Contracting State, an authority to conclude contracts in the name of that resident, unless the exercise of such authority is limited to the purchase of goods or merchandise for that resident.

(5) A resident of one of the Contracting States shall not be deemed to have a permanent establishment in the other Contracting State merely because such resident engages in industrial or commercial activity in that other Contracting State through a broker, general commission agent, or any other agent of an independent status, where such broker or agent is acting in the ordinary course of his business.

(6) A resident of one of the Contracting States shall not be deemed to have a permanent establishment in the other Contracting State merely because such resident sells at the termination of a trade fair or convention in such other Contracting State goods or merchandise which such resident displayed at such trade fair or convention.

(7) In determining whether a resident of one Contracting State has a permanent establishment in the other Contracting State there shall not be taken into account the fact that such resident may be related to either a resident of the other Contracting State or to any other person who engages in business in that other Contracting State.

(8) The principles set forth in paragraphs (1) through (7) shall be applied in determining for purposes of this Convention whether there is a permanent establishment in a State other than one of the Contracting States or whether a person other than a resident of one of the Contracting States has a permanent establishment in one of the Contracting States.

ARTICLE 6

GENERAL RULES OF TAXATION

(1) A resident of one of the Contracting States may be taxed by the other Contracting State on any income from sources within that other Contracting State and only on such income, subject to any limitations set forth in this Convention. For this purpose, the rules set forth in Article 4 (Source of Income) shall be applied to determine the source of income.

(2) The provisions of this Convention shall not be construed to restrict in any manner any exclusion, exemption, deduction, credit, or other allowance now or hereafter accorded—

(a) By the laws of one of the Contracting States in determination of the tax imposed by that Contracting State, or

(b) By any other agreement between the Contracting States.

(3) Notwithstanding any provisions of this Convention except paragraph (4), a Contracting State may tax its residents (as determined under Article 3 (Fiscal Residence)) and its citizens as if this Convention had not come into effect.

(4) The provisions of paragraph (3) shall not affect:

(a) The benefits conferred by a Contracting State under paragraph 3 of Article 19 (Private Pensions and Annuities) and under Articles 20 (Social Security Payments), 25 (Relief from Double Taxation), 26 (Nondiscrimination), and 27 (Mutual Agreement Procedure); and

(b) The benefits conferred by a Contracting State under Articles 21 (Governmental Functions), 22 (Teachers), 23 (Students and Trainees), and 30 Diplomatic and Consular Officers) upon individuals who are neither citizens of, nor have immigrant status in, that Contracting State.

(5) The competent authorities of the two Contracting States may each prescribe regulations necessary to carry out the provisions of this Convention.

ARTICLE 7

INCOME FROM REAL PROPERTY

(1) Income from real property, including royalties and other payments in respect of the exploitation of natural resources and gains derived from the sale, exchange, or other disposition of such property or of the right

giving rise to such royalties or other payments, may be taxed by the Contracting State in which such real property or natural resources are situated. For purposes of this Convention, interest on indebtedness secured by real property or secured by a right giving rise to royalties or other payments in respect of the exploitation of natural resources shall be regarded as income from real property.

(2) Paragraph (1) shall apply to income derived from the usufruct, direct use, letting, or use in any other form of real property.

(3) For purposes of paragraph (1) of this Article and paragraph (4) of Article 4 (Source of Income), gains from the alienation of shares of a corporation or of an interest in a partnership, estate, or trust, the property of which consists, directly or indirectly, principally of real property situated in a Contracting State, shall be regarded as income from real property.

(4) Income or gain referred to in this Article derived from sources in a Contracting State by a resident of the other Contracting State may be taxed by both Contracting States.

ARTICLE 8

BUSINESS PROFITS

(1) Industrial or commercial profits of a resident of one of the Contracting States shall be exempt from tax by the other Contracting State unless the resident has a permanent establishment in that other Contracting State. If the resident has a permanent establishment in that other Contracting State, tax may be imposed by that other Contracting State on the industrial or commercial profits of the resident but only on so much of them as are attributable to the permanent establishment.

(2) Where a resident of one of the Contracting States has a permanent establishment in the other Contracting State, there shall in each Contracting State be attributed to the permanent establishment the industrial or commercial profits which would reasonably be expected to have been derived by it if it were an independent entity engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the resident of which it is a permanent establishment.

(3) In the determination of the industrial or commercial profits of a permanent establishment, there shall be allowed as deductions expenses which are reasonably connected with such profits, including executive and general administrative expenses, whether incurred in the Contracting State in which the permanent establishment is situated or elsewhere.

(4) No profits shall be attributed to a permanent establishment of a resident of one of the Contracting States in the other Contracting State merely by reason of the purchase of goods or merchandise by that permanent establishment, or by the resident of which it is a permanent establishment, for the account of that resident.

(5) The term "industrial or commercial profits" includes, but is not limited to, income derived from manufacturing, mercantile, banking, insurance, agricultural, fishing or mining activities, the operation of ships or aircraft, the furnishing of services, the rental of tangible personal (movable) property, and the rental or licensing of motion picture films or films or tapes used for radio or television broadcasting. Such term does not include the performance of personal services by an individual either as an employee or in an independent capacity.

(6) For purposes of paragraph (1), industrial or commercial profits which are attributable to a permanent establishment include income from dividends, interest, royalties (as defined in paragraph (2) of Article 13 (Royalties)), and capital gains and income derived from property and natural resources, but only if such income is effectively connected with the permanent establishment. To determine whether income is effectively connected with a permanent establishment, the factors taken into account shall include whether the rights or property giving rise to such income are used in or held for use in carrying on an activity giving rise to industrial or commercial profits through such permanent establishment and whether the activities carried on through such permanent establishment were a material factor in the realization of such income. For this purpose, due regard shall be given to whether or not such property or rights or such income were accounted for through such permanent establishment.

(7) Where industrial or commercial profits include items of income which are dealt with separately in other articles of this Convention, the provisions of those articles shall, except as otherwise provided therein, supersede the provisions of this Article.

ARTICLE 9

SHIPPING AND AIR TRANSPORT

(1) Notwithstanding Article 8 (Business Profits: Profits derived by a resident of a Contracting State from the operation of ships or aircraft in international traffic shall be taxable only in that Contracting State.

(2) For purposes of this Article, income derived from the operation in international traffic of ships or aircraft does not include dividends received by a person by virtue of an ownership interest in a corporation engaged in the operation of ships or aircraft in international traffic, and includes—

(a) Income derived from the rental of ships or aircraft operated in international traffic if such rental income is incidental to other income described in paragraph (1); and

(b) Income derived from the use, maintenance, and lease of—

(i) Containers,

(ii) Trailers for the inland transport of containers, and

(iii) Other related equipment in connection with the operation by the resident in international traffic of ships or aircraft described in paragraph (1).

(3) The existing exemption of United States air transport enterprises afforded by Decree of the Egyptian Council of Ministers shall cease to have effect upon the entry into force of this Convention.

ARTICLE 10

RELATED PERSONS

(1) Where a person subject to the taxing jurisdiction of one of the Contracting States and any other person are related and where such related

persons make arrangements or impose conditions between themselves which are different from those which would be made between independent persons, any income, deductions, credits, or allowances which would, but for those arrangements or conditions, have been taken into account in computing the income (or loss) of, or the tax payable by, one of such persons, may be taken into account in computing the amount of the income subject to tax and the taxes payable by such person.

(2) Where a redetermination has been made by one Contracting State of the income of one of its residents in accordance with paragraph (1), then the other Contracting State shall, if it agrees with such redetermination and if necessary to prevent double taxation, make a corresponding adjustment to the income of a person in such other Contracting State related to such resident. In the event the other Contracting State disagrees with such redetermination, the two Contracting States shall endeavor to reach agreement in accordance with the mutual agreement procedure in paragraph (2) of Article 27 (Mutual Agreement Procedure).

(3) For purposes of this Convention, a person is related to another person if either person owns or controls directly or indirectly the other, or if any third person or persons own or control directly or indirectly both. For this purpose, the term "control" includes any kind of control, whether or not legally enforceable, and however exercised or exercisable.

ARTICLE 11

DIVIDENDS

(1) Dividends derived from sources within one of the Contracting States by a resident of the other Contracting State may be taxed by both Contracting States.

(2) The rate of tax imposed by the United States on dividends paid by a United States corporation to a resident of Egypt shall not exceed—

(a) 15 percent of the gross amount of the dividend; or

(b) When the recipient is a corporation, 5 percent of the gross amount of the dividend if—

(i) During the part of the paying corporation's taxable year which precedes the date of payment of the dividend and during the whole of its prior taxable year (if any), at least 10 percent of the outstanding shares of the voting stock of the paying corporation was owned by the recipient corporation, and

(ii) Not more than 25 percent of the gross income of the paying corporation for such prior taxable year (if any) consists of interest or dividends (other than interest derived from the conduct of a banking, insurance, or financing business and dividends or interest received from subsidiary corporations, 50 percent or more of the outstanding shares of the voting stock of which is owned by the paying corporation at the time such dividends or interest is received).

(3) Dividends paid by an Egyptian corporation to a resident of the United States shall in Egypt be subject (a) to the tax on income derived from movable capital, the defense tax, national security tax, war tax, the supplementary taxes on the foregoing, and substantially similar taxes enacted after the date of signature of this Convention (which taxes shall be deducted at source), provided that such dividends, if distributed out of the taxable profits of the same taxable year and not out of accumulated reserves or assets, shall be allowed as a deduction from the amount of the company's taxable income or profits subject to tax as industrial or commercial profits, and (b) when paid to a natural person, to the general income tax levied on net total income. However, the general income tax thus imposed shall in no case exceed an average of 20 percent of the net dividends payable to such natural person. The dividends payable to a United States corporation shall not be subject to any taxes other than those described in subparagraph (a).

(4) Paragraphs (2) and (3) shall not apply if such dividends are treated, under paragraph (6) of Article 8 (Business Profits), as industrial or commercial profits attributable to a permanent establishment which the recipient, a resident of one Contracting State, has in the other Contracting State. In such case the provisions of Article 8 shall apply.

(5) Dividends paid by a United States corporation whose activities lie solely or mainly in Egypt shall in Egypt be treated in the manner provided by paragraph (3).

(6) Dividends deemed to be paid, according to the provisions of Egyptian taxation law, out of yearly profits by a permanent establishment maintained in Egypt by a United States corporation whose activities extend to countries other than Egypt shall in Egypt be treated in the manner provided by paragraph (3).

(7) The term "dividends" as used in this Article means income from shares, "jouissance" shares or "jouissance" rights, mining shares, founders' shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the corporation making the distribution is a resident.

ARTICLE 12

INTEREST

(1) Interest derived by a resident of one of the Contracting States from sources within the other Contracting State may be taxed by both Contracting States.

(2) Interest derived by a resident of one of the Contracting States from sources within the other Contracting State shall not be taxed by the other Contracting State at a rate in excess of 15 percent of the gross amount of such interest.

(3) Notwithstanding paragraphs (1) and (2), interest beneficially derived by (a) one of the Contracting States, or by an instrumentality of that Contracting State, not subject to tax by that Contracting State on its income, or (b) a resident of such Contracting State with respect to loans made, guaranteed, or insured by that Contracting State or an instrumentality thereof, shall be exempt from tax by the other Contracting State.

(4) Interest paid by a resident of one of the Contracting States to a person other than a resident of the other Contracting State (and in the case of interest paid by a resident of Egypt to a person other than a citizen of the

United States) shall be exempt from tax by the other Contracting State unless such interest is treated as income from sources within the other Contracting State under paragraph (2) of Article 4 (Source of Income).

(5) Paragraphs (2), (3), and (4) shall not apply if the interest is treated, under paragraph (6) of Article 8 (Business Profits) as industrial or commercial profits attributable to a permanent establishment which the recipient, a resident of one Contracting State, has in the other Contracting State. In such a case, the provisions of Article 8 shall apply.

(6) Where an amount is paid to a related person and would be treated as interest but for the fact that it exceeds an amount which would have been paid to an unrelated person, the provisions of this Article shall apply only to so much of the amount as would have been paid to an unrelated person. In such a case the excess amount may be taxed by each Contracting State according to its own law, including the provisions of this Convention where applicable.

(7) The term "interest" as used in this Convention means income from money lent and other income which under the taxation law of the Contracting State in which the income has its source is assimilated to income from money lent, but does not include interest on indebtedness secured by mortgages on real estate or other amounts considered income from real property under Article 7 (Income from Real Property).

ARTICLE 13

ROYALTIES

(1) Royalties derived by a resident of one of the Contracting States from sources within the other Contracting State may be taxed by both Contracting States. However, royalties shall not be taxed by the other Contracting State at a rate in excess of 15 percent of the gross amount of such royalty.

(2) For purposes of this Article the term "royalties" means:

(a) Payments of any kind made as consideration for the use of, or the right to use, copyrights of literary, artistic, or scientific works, but not including copyrights of motion picture films or films or tapes used for radio or television broadcasting which are industrial and commercial profits within the meaning of paragraph (5) of Article 8 (Business Profits), and patents, designs, models, plans, secret processes or formulae, trademarks, or other like property or rights; and

(b) Gains derived from the sale, exchange, or other disposition of any such property or rights to the extent that the amounts realized on such sale, exchange, or other disposition for consideration are contingent on the productivity, use or disposition of such property or rights.

(3) Paragraph (1) shall not apply if the recipient of the royalty, being a resident of one of the Contracting States, has in the other Contracting State a permanent establishment and the property or rights giving rise to the royalty is effectively connected with such permanent establishment. In such a case, the provisions of Article 8 (Business Profits) shall apply.

(4) The provisions of this Article shall not apply to dividends on founders' shares issued in Egypt as consideration for the rights mentioned in paragraph (2) of this Article and which are taxed in accordance with the provisions of Article 1 of Law No. 14 of 1939. In such a case, the provisions of Article 11 (Dividends) shall apply.

(5) Where an amount is paid to a related person and would be treated as a royalty but for the fact that it exceeds an amount which would have been paid to an unrelated person, the provisions of this Article shall apply only to so much of the amount as would have been paid to an unrelated person. In such a case, the excess amount may be taxed by each Contracting State according to its own law, including the provisions of this Convention where applicable.

ARTICLE 14

CAPITAL GAINS

(1) A resident of one of the Contracting States shall be exempt from tax by the other Contracting State on gains from the sale, exchange, or other disposition of capital assets unless—

(a) The gain is derived by a resident of one of the Contracting States from the sale, exchange, or other disposition of property described in Article 7 (Income from Real Property) situated within the other Contracting State,

(b) The gain arises out of a sale, exchange, or other disposition described in paragraph (2)(b) of Article 13 (Royalties),

(c) The gain is treated, under paragraph (6) of Article 8 (Business Profits), as industrial or commercial profits attributable to a permanent establishment which the recipient has in such other Contracting State, or

(d) The recipient of the gain, being an individual who is a resident of one of the Contracting States is present in the other Contracting State for a period or periods aggregating 183 days or more during the taxable year.

(2) In the case of gains described in paragraph (1)(a), the provisions of Article 7 (Income from Real Property) shall apply. In the case of gains described in paragraph (1)(b), the provisions of Article 13 (Royalties) shall apply. In the case of gains described in paragraph (1)(c), the provisions of Article 8 (Business Profits) shall apply.

ARTICLE 15

INDEPENDENT PERSONAL SERVICES

(1) Income derived by an individual who is a resident of one of the Contracting States from the performance of personal services in an independent capacity may be taxed by that Contracting State. Except as provided in paragraph (2), such income shall be exempt from tax by the other Contracting State.

(2) Income derived by an individual who is a resident of one of the Contracting States from the performance of personal services in an independent capacity in the other Contracting State may be taxed by that other Contracting State, if the individual is present in that other Contracting State for a period or periods aggregating 90 days or more in the taxable year.

(3) The term "personal services in an independent capacity" includes, but is not limited to, scientific, literary, artistic, educational or teaching activities, as well as independent activities of physicians, lawyers, engineers, architects, dentists, and accountants.

ARTICLE 16

DEPENDENT PERSONAL SERVICES

(1) Except as provided in Articles 21 (Governmental Functions), 22 (Teachers), and 23 (Students and Trainees), wages, salaries, and similar remuneration derived by an individual who is a resident of one of the Contracting States from labor or personal services performed as an employee, including income from services performed by an officer of a corporation or company, may be taxed by that Contracting State. Except as provided by paragraph (2) and in Articles 19 (Private Pensions and Annuities), 21 (Governmental Functions), 22 (Teachers), and 23 (Students and Trainees), such remuneration derived from sources within the other Contracting State may also be taxed by that other Contracting State.

(2) Remuneration described in paragraph (1) derived by an individual who is a resident of one of the Contracting States shall be exempt from tax by the other Contracting State if—

(a) He is present in that other Contracting State for a period or periods aggregating less than 90 days in the taxable year;

(b) He is an employee of a resident of, or of a permanent establishment maintained in, the first-mentioned Contracting State;

(c) The remuneration is not borne as such by a permanent establishment which the employer has in that other Contracting State; and

(d) The remuneration is subject to tax in the first-mentioned Contracting State.

(3) Notwithstanding paragraphs (1) and (2), remuneration derived by an employee of a resident of one of the Contracting States for labor or personal services performed as a member of the regular complement of a ship or aircraft operated in international traffic by a resident of that Contracting State may be taxed by that Contracting State.

ARTICLE 17

PUBLIC ENTERTAINER

Notwithstanding Articles 15 (Independent Personal Services) and 16 (Dependent Personal Services), the income derived by an individual who is a resident of one Contracting State from his performance of personal services in the other Contracting State as a public entertainer, such as a theater, motion picture, radio or television artist, a musician, or an athlete, may be taxed by the other Contracting State, but only if the gross amount of such income exceeds 400 United States dollars or its equivalent in Egyptian pounds for each day such person is present in the other Contracting State for the purpose of performing such services therein.

ARTICLE 18

AMOUNTS RECEIVED FOR FURNISHING PERSONAL SERVICES OF OTHERS

(1) Notwithstanding the provisions of Article 8 (Business Profits), amounts received by a resident of one of the Contracting States in consideration of furnishing in the other Contracting State the personal services of one or more other persons shall be subject to tax under the taxation laws of each Contracting State to the extent that—

(a)(i) The person for whom the services were furnished designated the person or persons who would render the services, whether or not he had the legal right to do so and whether or not the designation had been made formally;

(ii) The person for whom the services were furnished had the right to designate the person or persons who would render the services; or

(iii) By reason of the facts and circumstances the arrangement for personal services had the effect of designating the person or persons who would render the services; and

(b) The resident of the first-mentioned Contracting State directly or indirectly pays compensation for such services to any person, other than another resident of the first-mentioned Contracting State or of that other Contracting State who is subject to tax on such compensation.

(2) Paragraph (1) shall not apply to any amount received if it is established to the satisfaction of the competent authority of that other Contracting State, with respect to such amount, that neither the creation or organization of the resident of the first-mentioned Contracting State (where such resident is a corporation or other entity), nor the furnishing of the services through such resident has the effect of a substantial reduction of income, war profits, excess profits, or similar taxes.

ARTICLE 19

PRIVATE PENSIONS AND ANNUITIES

(1) Except as provided in Article 21 (Governmental Functions), pensions and other similar remuneration paid to an individual in consideration of past employment shall be taxable only in the Contracting State of which he is a resident.

(2) Alimony and annuities paid to an individual who is a resident of one of the Contracting States shall be taxable only in that Contracting State.

(3) Child support payments made by an individual who is a resident of one of the Contracting States to an individual who is a resident of the other Contracting State shall be exempt from tax in that other Contracting State.

(4) The term "pensions and other similar renumeration," as used in this Article, means periodic payments other than social security payments covered in Article 20 (Social Security Payments) made (a) by reason of retirement or death and in consideration for services rendered or (b) by way of compensation for injuries or sickness received in connection with past employment.

(5) The term "annuities," as used in this Article, means a stated sum paid periodically at stated times during life, or during a specified number of years, under an obligation to make the payments in return for adequate and full consideration (other than services rendered).

(6) The term "alimony," as used in this Article, means periodic payments made pursuant to a written separation agreement or a decree of divorce, separate maintenance, or compulsory support which payments are taxable to the recipient under the internal laws of the Contracting State of which he is a resident.

(7) The term "child support payments," as used in this Article, means periodic payments for the support of a minor child made pursuant to written separation agreement or a decree of divorce, separate maintenance, or compulsory support.

ARTICLE 20

SOCIAL SECURITY PAYMENTS

Social security payments and similar amounts paid by one of the Contracting States to an individual who is a resident of the other Contracting State shall be taxable only in the other Contracting State. This Article shall not apply to payments described in Article 21 (Governmental Functions).

ARTICLE 21

GOVERNMENTAL FUNCTIONS

(1) Wages, salaries, or similar remuneration, including pensions, annuities, or similar benefits, paid from public funds of one of the Contracting States

(a) To a citizen of that Contracting State, or

(b) To a citizen of a State other than a Contracting State who comes to the other Contracting State expressly for the purpose of being employed by the first-mentioned Contracting State for labor or personal services performed as an employee of the national Government of that Contracting State, or any agency thereof, in the discharge of functions of a governmental nature shall be exempt from tax by the other Contracting State.

(2) The provisions of Articles 16 (Dependent Personal Services) and 19 (Private Pensions and Annuities) shall apply to remuneration or pensions in respect of services rendered in connection with any trade or business carried on by one of the Contracting States or any agency thereof.

ARTICLE 22

TEACHERS

(1) Where a resident of one of the Contracting States is invited by the Government of the other Contracting State, a political subdivision, or a local authority thereof, or by a university or other recognized educational institution in that other Contracting State to come to that other Contracting State for a period not expected to exceed 2 years for the purpose of teaching or engaging in research, or both, at a university or other recognized educational institution and such resident comes to that other Contracting State primarily for such purpose, his income from personal services for teaching or research at such university or educational institution shall be exempt from tax by that other Contracting State for a period not exceeding 2 years from the date of his arrival in that other Contracting State.

(2) This Article shall not apply to income from research if such research is undertaken not in the public interest but primarily for the private benefit of a specific person or persons.

ARTICLE 23

STUDENTS AND TRAINEES

(1)(a) An individual who is a resident of one of the Contracting States at the time he becomes temporarily present in the other Contracting State and who is temporarily present in that other Contracting State for the primary purpose of—

(i) Studying at a university or other recognized educational institution in that other Contracting State, or

(ii) Securing training required to qualify him to practice a profession or professional specialty, or

(iii) Studying or doing research as a recipient of a grant, allowance, or award from a governmental, religious, charitable, scientific, literary, or educational organization, shall be exempt from tax by that other Contracting State with respect to amounts described in subparagraph (b) for a period not exceeding 5 taxable years from the date of his arrival in that other Contracting State, and for such additional period of time as is necessary to complete, as a full-time student, educational requirements as a candidate for a postgraduate or professional degree from a recognized educational institution.

(b) The amounts referred to in subparagraph (a) are—

(i) Gifts from abroad for the purpose of his maintenance, education, study, research, or training;

(ii) The grant, allowance, or award; and

(iii) Income from personal services performed in that other Contracting State in an amount not in excess of 3,000 United States dollars or its equivalent in Egyptian pounds for any taxable year.

(2) An individual who is a resident of one of the Contracting States at the time he becomes temporarily present in the other Contracting State and who is temporarily present in that other Contracting State as an employee of, or under contract with, a resident of the first-mentioned Contracting State, for the primary purpose of—

(a) Acquiring technical, professional, or business experience from a person other than that resident of the first-mentioned Contracting State or other than a person related to such resident, or

(b) Studying at a university or other recognized educational institution in that other Contracting State, shall be exempt from tax by that other Contracting State for a period not exceeding 12 consecutive months with respect to his income from personal services in an aggregate amount not in excess of 7,500 United States dollars or its equivalent in Egyptian pounds.

(3) An individual who is a resident of one of the Contracting States at the time he becomes temporarily present in the other Contracting State and who is temporarily present in that other Contracting State for a period not exceeding 1 year, as a participant in a program sponsored by the Government of that other Contracting State, for the primary purpose of training, research, or study, shall be exempt from tax by that other Contracting State with respect to his income from personal services in respect of such training, research, or study performed in that other Contracting State in an aggregate amount not in excess of 10,000 United States dollars or its equivalent in Egyptian pounds.

(4) The benefits provided under Article 22 (Teachers) and paragraph (1) of this Article shall, when taken together, extend only for such period of time, not to exceed 5 taxable years from the date of arrival of the individual claiming such benefits, as may

reasonably or customarily be required to effectuate the purpose of the visit, and for such additional period of time as is necessary to complete, as a full-time student, educational requirements as a candidate for a postgraduate or professional degree from a recognized educational institution. The benefits provided under Article 22 (Teachers) shall not be available to an individual if, during the immediately preceding period, such individual enjoyed the benefits of paragraph (1) of this Article.

ARTICLE 24

INVESTMENT OR HOLDING COMPANIES

A corporation of one of the Contracting States deriving dividends, interest, royalties, or capital gains from sources within the other Contracting State shall not be entitled to the benefits of Articles 11 (Dividends), 12 (Interest), 13 (Royalties), or 14 (Capital Gains) if—

(a) By reason of special measures the tax imposed on such corporation by the first-mentioned Contracting State with respect to such dividends, interest, royalties, or capital gains is substantially less than the tax generally imposed by such Contracting State on corporate profits, and

(b) 25 percent or more of the capital of such corporation is held of record or is otherwise determined, after consultation between the competent authorities of the Contracting States, to be owned, directly or indirectly, by one or more persons who are not individual residents of the first-mentioned Contracting State (or, in the case of an Egyptian corporation, who are citizens of the United States).

ARTICLE 25

RELIEF FROM DOUBLE TAXATION

Double taxation of income shall be avoided in the following manner:

(1) In accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle hereof), the United States shall allow to a citizen or resident of the United States as a credit against the United States tax the appropriate amount of taxes paid or accrued to Egypt and, in the case of a United States corporation owning at least 10 percent of the voting stock of an Egyptian corporation from which it receives dividends in any taxable year, shall allow credit for the appropriate amount of taxes paid or accrued to Egypt by the Egyptian corporation paying such dividends with respect to the profits out of which such dividends are paid. Such appropriate amount shall be based upon the amount of tax paid or accrued to Egypt, but the credit shall not exceed the limitations (for the purpose of limiting the credit to the United States tax on income from sources within Egypt or on income from sources outside of the United States) provided by United States law for the taxable year. For the purpose of applying the United States credit in relation to taxes paid or accrued to Egypt, the rules set forth in Article 4 (Source of Income) shall be applied to determine the source of income. For purposes of applying the United States credit in relation to taxes paid or accrued to Egypt, the taxes referred to in paragraphs (1)(b) and (2) of Article 1 (Taxes Covered) shall be considered to be income taxes.

(2) Egypt shall allow to a citizen or resident of Egypt as a credit against Egyptian tax the appropriate amount of income taxes paid or accrued to the United States and, in the case of an Egyptian corporation owning at least 10 percent of the voting stock of a United States corporation from which it receives dividends in any taxable year, shall allow credit for the appropriate amount of taxes paid or accrued to the United States by the United States corporation paying such dividends with respect to the profits out of which such dividends are paid. Such appropriate amount shall be based upon the amount of tax paid or accrued to the United States but shall not exceed that portion of Egyptian tax which such citizen's or resident's net income from sources within the United States bears to his entire net income for the same taxable year. For purpose of applying the Egyptian credit in relation to taxes paid or accrued to the United States, the rules set forth in Article 4 (Source of Income) shall be applied to determine the source of income.

ARTICLE 26

NONDISCRIMINATION

(1) A citizen of one of the Contracting States who is a resident of the other Contracting State shall not be subject in that other Contracting State to more burdensome taxes than a citizen of that other Contracting State who is a resident thereof.

(2) A permanent establishment which a resident of one of the Contracting States has in the other Contracting State shall not be subject in that other Contracting State to more burdensome taxes than a resident of that other Contracting State carrying on the same activities. This paragraph shall not be construed as—

(a) Obliging a Contracting State to grant to individual residents of the other Contracting State any personal allowances, reliefs, or deductions for taxation purposes on account of civil status or family responsibilities which it grants to its own individual residents;

(b) Obliging Egypt to grant United States corporations the exemptions granted to Egyptian corporations by Articles 5 and 6 of Law 14 of 1939; or

(c) Affecting the application in Egypt of the first and second paragraphs of Article 11 and Article 11 bis of Law 14 of 1939.

(3) A corporation of one of the Contracting States, the capital of which is wholly or partly owned or controlled, directly, or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned Contracting State to any taxation or any requirement connected with taxation which is other or more burdensome than the taxation and requirements to which a corporation of the first-mentioned Contracting State carrying on the same activities, the capital of which is wholly owned or controlled by one or more residents of the first-mentioned Contracting State, is or may be subjected.

ARTICLE 27

MUTUAL AGREEMENT PROCEDURE

(1) Where a resident or citizen of one of the Contracting States considers that the action of one or both of the Contracting States results or will result for him in taxation not in accordance with this Convention, he may, notwithstanding the remedies provided by the national laws of the Contracting States, present his case to the competent authority of the Contracting State of which he is a resident or citizen. Should the resident's or citizen's claim be considered to have merit by the competent authority of the Contracting State to which the claim is made, it shall endeavor to come to an agreement with the competent authority of the other Contracting State with a view to the avoidance of taxation not in accordance with the provisions of this Convention.

(2) The competent authorities of the Contracting States shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the application of this Convention. In particular, the competent authorities of the Contracting States may agree—

(a) To the same attribution of industrial or commercial profits to a resident of one of the Contracting States and its permanent establishment situated in the other Contracting State;

(b) To the same allocation of income, deductions, credits, or allowances between a resident of one of the Contracting States and any related person and to the readjustment of taxes imposed by each Contracting State to reflect such allocation;

(c) To the same determination of the source of particular items of income; or

(d) To the same characterization of particular items of income.

(3) The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement in the sense of this Article. When it seems advisable for the purpose of reaching agreement, the competent authorities may meet together for an oral exchange of opinions.

(4) In the event that the competent authorities reach such an agreement, taxes shall be imposed on such income, and refund or credit of taxes shall be allowed, by the Contracting States in accordance with such agreement, notwithstanding any procedural rule (including statutes of limitations) applicable under the law of either Contracting State.

ARTICLE 28

EXCHANGE OF INFORMATION

(1) The competent authorities shall exchange such information as is necessary for carrying out the provisions of this Convention or for the prevention of fraud or for the administration of statutory provisions concerning taxes to which this Convention applies provided the information is of a class that can be obtained under the laws and administrative practices of each Contracting State with respect to its own taxes.

(2) Any information so exchanged shall be treated as secret, except that such information may be—

(a) Disclosed to any person concerned with, or

(b) Made part of a public record with respect to, the assessment, collection, or enforcement of, or litigation with respect to, the taxes to which this Convention applies.

(3) No information shall be exchanged which would be contrary to public policy.

(4) If specifically requested by the competent authority of a Contracting State, the competent authority of the other Contracting State shall provide information under this Article in the form of depositions of witnesses and copies of unedited original documents (including books, papers, statements, records, accounts, or writings), to the same extent such depositions and documents can be obtained under the laws and administrative practices of each Contracting State with respect to its own taxes.

(5) Depositions and evidence which may be furnished in accordance with this Article shall not be withheld by reason of any doctrine of law under which international judicial assistance is not accorded in tax matters.

(6) The exchange of information shall be carried out promptly either on a routine basis or on request with reference to particular cases. The competent authorities of the Contracting States may agree on the list of information which shall be furnished on a routine basis.

ARTICLE 29

ASSISTANCE IN COLLECTION

(1) Each of the Contracting States shall endeavor to collect on behalf of the other Contracting State such taxes imposed by that other Contracting State as will ensure that any exemption or reduced rate of tax granted under this Convention by that other Contracting State shall not be enjoyed by persons not entitled to such benefits.

(2) In no case shall this Article be construed so as to impose upon a Contracting State the obligations to carry out measures at variance with the laws or administrative practices of either Contracting State with respect to the collection of its own taxes.

ARTICLE 30

DIPLOMATIC AND CONSULAR OFFICERS

Nothing in this Convention shall affect the fiscal privileges of diplomatic and consular officials under the general rules of international law or under the provisions of special agreements.

ARTICLE 31

ENTRY INTO FORCE

This Convention shall be subject to ratification in accordance with the constitutional procedures of each Contracting State and instruments of ratification shall be exchanged at ________ as soon as possible. It shall enter into force 30 days after the date of exchange of instruments of ratification and shall then have effect for the first time:

(a) As respects the rate of withholding tax, to amounts paid on or after the first day of the second month following the date on which this Convention enters into force.

(b) As respects other taxes, to taxable years beginning on or after January 1 of the year following the date on which this Convention enters into force.

ARTICLE 32

TERMINATION

(1) This Convention shall remain in force until terminated by one of the Contracting States. Either Contracting State may terminate the Convention at any time after 5 years from the date on which this Convention enters into force provided that at least 6 months prior notice of termination has been given through diplomatic channels. In such event, the Convention shall cease to have force and effect as respects income of calendar years or taxable years beginning (or, in the case of taxes payable at the source, payments made) on or after January 1 next following the expiration of the 6-month period.

(2) Notwithstanding the provisions of paragraph (1), and upon prior notice to be given through diplomatic channels, the provisions of this Convention exempting social security payments from taxation in the Contracting State which makes the payments may be terminated by either Contracting State at any time after this Convention enters into force.

IN WITNESS WHEREOF, the undersigned, duly authorized thereto, have signed this Convention.

DONE at Cairo in duplicate, this 24th day of August 1980.

Senate Executive Report No. 97-27

[Bracketed numerals indicate official report page numbers]

TAX CONVENTION WITH THE ARAB REPUBLIC OF EGYPT

NOVEMBER 10, 1981.

MR. PERCY, from the Committee on Foreign Relations, submitted the following report to accompany Ex. U, 96th Cong., 2d sess.

The Committee on Foreign Relations, to which was referred the Tax Treaty with the Arab Republic of Egypt [1] for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and the encouragement of international trade and investment (Executive U), having considered the same, reports favorably thereon subject to a reservation and an understanding and recommends that the Senate give its advice and consent to ratification thereof.

I. PURPOSE

There is presently no income tax treaty in force between the United States and Egypt. The principal purpose of the proposed income tax treaty between the United States and Egypt is to reduce or eliminate potential double taxation of income earned by citizens and residents of either country from sources within the other country and to prevent avoidance or evasion of the income taxes of the two countries. The proposed treaty is intended to promote closer economic cooperation between the two countries and to eliminate possible barriers to trade caused by overlapping taxing jurisdictions of the two countries.

[2] II. BACKGROUND

The proposed treaty with Egypt was signed on August 24, 1980. The Tax Treaty was transmitted to the Senate for advice and consent to ratification on November 12, 1980.

The proposed treaty replaced the proposed treaty with Egypt which was signed on October 28, 1975, but never brought into force. That treaty was withdrawn from the Senate.

III. SUMMARY

This proposed treaty is substantially similar to other recent U.S. income tax treaties, to the U.S. model income tax treaty and to the model income tax treaty of the Organization for Economic Cooperation and Development (OEDC). However, there are certain departures from these models to reflect Egypt's status as a developing country, and the influence of the United Nations model for income tax treaties between developed and developing countries.

As in other United States tax treaties, the objectives of the treaty are principally achieved by each country agreeing to limit, in certain specified situations, its right to tax income derived from its territory by residents of the other. There are, however, several provisions which vary from the basic model.

(1) The proposed treaty provides (Article 11) that the United States is to reduce its withholding tax to 15 percent on dividends paid to Egyptian portfolio investors and five percent of dividends paid to direct investors. However, the treaty does not provide for a parallel reduction in Egyptian taxes. Under its laws, Egypt allows a deduction to corporations equal to the amount of any dividends paid out of current earnings. The treaty consequently does not limit the Egyptian tax imposed under Egyptian law on U.S. corporate shareholders. However, the treaty does limit the general income tax which Egypt would otherwise impose on U.S. individuals receiving dividends from Egyptian corporations to an average of 20 percent of the net dividend.

(2) Income from personal services (Articles 15 through 18) is treated in a slightly different manner than in many other U.S. treaties. Individuals performing personal services are to be subject to tax in the country where the services are performed if the individual is present in that country for 90 days within the tax year, instead of the longer period generally provided in U.S. treaties. An exception is provided for entertainers and athletes, whose services may be taxed in the country where performed if the gross income from the service exceeds $400 per day that the individual performs services in that country.

(3) The treaty generally provides for a 15-percent limit on the withholding rates of each country applicable to interest (Article 12), and royalties (Article 13).

(4) The treaty (Article 9) provides for an exemption of shipping income which is slightly broader than the exemption found in many [3] U.S. tax treaties. Under the treaty, income

---

[1] Page 219; Technical Explanation, page 243; Senate Executive D is not published.

from international shipping of a resident of one country is to be exempt in the other county. Most existing U.S. treaties limit the exemption to ships or aircraft registered in the country of the owner's residence, but this provision follows newer treaties and the current U.S. model.

The treaty also differs from U.S. internal law in its treatment of the gain from the sale of an interest in certain partnerships owning U.S. real estate.

IV. DATE OF ENTRY INTO FORCE AND TERMINATION

Entry into Force

The proposed treaty will enter into force 30 days following the exchange of the instruments of ratification. It will become effective with respect to withholding tax rates on the first day of the second month following the date on which the proposed treaty enters into force. With respect to all other taxes, it will become effective for taxable years beginning on or after January 1st of the year following the date on which the proposed treaty comes into force.

Termination

The proposed treaty will continue in force indefinitely, but either country may terminate it at any time after 5 years from its entry into force by giving at least 6 months' prior notice through diplomatic channels. If terminated, the termination will be effective with respect to income of taxable years beginning (or, in the case of withholding taxes, payments made) on or after January 1 next following the expiration of the 6-month period. The provisions of Article 20 (social security payments) may be terminated by either country at any time after the proposed treaty enters into force by prior notice given through diplomatic channels.

V. COMMITTEE ACTION

The Committee on Foreign Relations held public hearings on the proposed Egyptian tax treaty, and on other tax treaties, on September 24, 1981. The Committee considered the proposed treaty on October 27, 1981, and ordered it favorably reported with an understanding and a reservation by a vote of 14 yeas and no nays, with the recommendation that the Senate give its advice and consent to ratification of the treaty. Senators voting in the affirmative were: Charles H. Percy, Howard H. Baker, Jr., S. I. (Sam) Hayakawa, Richard G. Lugar, Charles McC. Mathias, Jr., Nancy Landon Kassebaum, Larry Pressler, Claiborne Pell, John Glenn, Paul S. Sarbanes, Edward Zorinsky, Paul E. Tsongas, Alan Cranston, and Christopher J. Dodd.

VI. COMMITTEE COMMENTS

The Committee on Foreign Relations approved the treaty subject to a reservation and an understanding. The understanding deals with Article 28, relating to exchange of information. The reservation deals with Article 7, relating to real estate.

[4] *Gain on the Disposition of Real Property*

On November 26, 1980, Congress passed the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA), which generally subjects foreign persons to U.S. tax on disposition of U.S. real estate made after June 18, 1980. Also, foreign persons disposing of stock in a U.S. corporation having 50 percent or more of its gross asset value comprised of U.S. real property interest are subject to U.S. taxation. Finally, the distribution (liquidating or nonliquidating) of a U.S. real property interest by a foreign corporation is subject to U.S. tax. In general, the FIRPTA rules were to override treaties but not until January 1, 1985.

The treaty is generally consistent with FIRPTA. However, it contains a provision, in paragraph (3) of Article 7, that would restrict the right of United States to apply its legislation.

Under the legislation, a foreign person disposing of an interest in a partnership, trust, or estate will be treated as disposing proportionately of its U.S. real property. Accordingly, a foreign person disposing of an interest in a partnership 35 percent of the assets of which consisted of U.S. real estate would be taxed on his gain equal to 35 percent of the gain of the disposition. The treaty, however, treats partnerships, trusts, and estates as entities and would only permit taxation of the gain on the disposition of an interest in those entities by a resident of Egypt if more than 50 percent of its assets consisted of U.S. real property interests. This entity characterization of a partnership conflicts with those Code rules that treat partnerships as flow-through entities, and directly overrides FIRPTA. The two separate rules will add substantial complexity to an area of the tax law that is already complex.

In view of the substantial public and Congressional concern with foreign investment in U.S. real estate that lead to the enactment of FIRPTA, and in view of the Congressional concern with overriding those provisions in this treaty expressed to this Committee, the Committee believes that it would not be appropriate to override FIRPTA. The Committee believes that it was clearly the intent of Congress that the U.S. should tax foreign investors when they derive gain on the disposition of an interest in U.S. real estate, even when the foreigner is a resident of a treaty partner. Accordingly, the Committee recommends the following reservation be approved by the Senate:

> Notwithstanding the provisions of paragraph (3) of Article 7 of the convention (which relates to the taxation of gains from the alienation of shares of a corporation or of an interest in a partnership, estate, or trust, the property of which consists, directly or indirectly, principally of real property situated in one of the countries), gain derived by a resident of a Contracting State, from the alienation or other disposition of an interest in a corporation, or an interest in a partnership, trust, or estate, which has an interest in real property located in the other Contracting State, or the assets of which are considered under the domestic law of that other Contracting State to consist, in whole or in part, of real property, or an interest therein, in that other State, may be taxed by that other State to the extent provided for by its domestic law. [5] In addition, gain derived by a corporation which is a resident of a Contracting State upon the distribution (including a distribution in liquidation or otherwise) of an interest in real property in the other Con-

> tracting State (as determined under the domestic law of the other Contracting State) may be taxed by that other Contracting State to the extent provided for by its domestic law.

Congressional Access to Information Received Under the Treaty

The proposed treaty contains a provision (Article 28) found in all U.S. income tax treaties, that requires the exchange of information which is necessary to carry out the provisions of the treaty or of the domestic tax laws of the two countries. The treaty also contains a provision (Article 27), found in most U.S. income tax treaties, that authorizes the competent authorities of the two countries to consult together to attempt to alleviate individual cases of double taxation or cases of taxation not in accordance with the treaty.

The Exchange of Information Article of the treaty contain a provision that limits access to information received by the United States and the treaty partner under the treaty to persons involved in the assessment or collection of taxes. A similar provision in existing treaties has been interpreted by the IRS as precluding Congressional access, specifically General Accounting Office (GAO) access, to mutual agreement case files. The IRS has indicated that they would not change this view. Accordingly, the appropriate Congressional Oversight Committees and the GAO have been hampered in their recent attempts to audit the IRS administration of mutual agreement cases which may involve significant revenue. Treasury has stated that this problem will be taken care of in future treaties, and that they are attempting to work out the problem for existing treaties.

This issue is of significant concern to the Senate Finance Committee, the House Ways and Means Committee, and the Joint Committee on Taxation, which are charged with the responsibility for oversight of the IRS. The Committee believes that such access is permitted and that those Committees and the GAO should, pursuant to the procedures established in the Internal Revenue Code, have access to information exchanged under the treaties, including the mutual agreement case files, where they believe it is necessary to carry out their oversight functions. Accordingly, the Committee recommends the following understanding be approved by the Senate:

> That appropriate Congressional committees and the General Accounting Office shall be afforded access to the information exchanged under this treaty where such access is necessary to carry out ther oversight responsibilities, subject only to the limitations and procedures of the Internal Revenue Code.

The effect of this understanding is to make clear that the treaty authorizes the Finance Committee, the Ways and Means Committee, and the Joint Committee on Taxation, as well as the GAO, to have access to all information received under the treaty.

[6] VII. BUDGET IMPACT

The Committee estimates that the effect of the proposed treaty on budget receipts will be negligible.

In accordance with the objectives of section 403 of the Budget Act, the Committee advises that the Director of the Congressional Budget Office has examined the Committee's budget estimate and agrees that the effect on budget receipts will be negligible. In keeping with the spirit of section 308(a) of the Budget Act, and after consultation with the Director of the Congressional Budget Office, the Committee states that the treaty does not provide any new budget authority or any new or increased tax expenditures.

[7] VIII. EXPLANATION OF TREATY PROVISIONS

A detailed, article-by-article explanation of the proposed tax treaty between the United States and Egypt is presented below.

Article 1. Taxes Covered

The proposed treaty applies to taxes on income that are imposed by either country. In the case of the United States, it applies to the Federal income taxes imposed under the Internal Revenue Code but excluding the personal holding company tax or the accumulated earning tax. Thus, the right of the United States to impose these taxes is preserved.

The treaty also applies to the following taxes of Egypt: the tax on income derived from immovable property, the tax on income from movable capital, the tax on commercial and industrial profits, the tax on wages, salaries, indemnities, and pensions, the tax on profits from noncommercial professions, the General income tax, the Defense tax, the National security tax, the War tax, and any supplementary taxes imposed as a percentage of any of the above taxes. Under Article 25 these taxes are designated as income taxes for purposes of the U.S. foreign tax credit.

The proposed treaty contains a provision generally found in U.S. income tax treaties which applies the treaty to substantially similar taxes which either country may impose after the date on which the treaty was signed. The countries are obligated to notify the other of any changes is their respective tax laws and of the adoption of any new taxes.

Additionally, the nondiscrimination provision (Article 26) of the treaty applies to all taxes imposed at the national, state, or local level by the United States or Egypt. The exchange of information provisions (Article 28) of the proposed treaty will apply to taxes of every kind imposed by the two countries at the national level.

Article 2. General Definitions

Most of the standard definitions found in U.S. income tax treaties are contained in the proposed treaty. The definition of the term "United States", means the United States of America, but does not include Puerto Rico, the Virgin Islands, Guam or any other possession. Accordingly, as in the case of all other tax treaties, they are not covered. When used in the geographical sense, the United States includes the territorial sea of the United States and the continental shelf of the United States insofar as the exploration and exploitation of natural resources on the continental shelf is concerned. This definition follows section 638 of the Internal Revenue Code.

The term "Egypt" means the Arab Republic of Egypt and, in certain situations relating to the exploration for natural resources, the seabed and subsoil of the submarine areas adjacent to Egypt (in general, the continental shelf).

[8] The proposed treaty defines the term international traffic to include all voyages of a ship or aircraft operated by a resident of one of the countries unless the voyage is solely within places in one country.

The terms U.S. or Egyptian corporation is defined as a corporation created or organized under the laws of the respective country. Accordingly, a corporation cannot be a dual resident.

The proposed treaty also contains the standard provision that undefined terms are to have the meaning which they have under the applicable tax laws of the country applying the treaty. Where a term is defined in a different manner by the two countries or where its meaning under the laws of either country is not readily determinable, the competent authorities of the two countries may establish a common meaning for the term in order to prevent double taxation or to further any other purpose of the treaty.

Article 3. Fiscal Residence

The benefits of the proposed treaty generally are available only to residents of one of the countries. The proposed treaty defines "resident of Egypt" and "resident of the United States," and in addition provides a set of rules to determine residence in the case of an individual with dual residence. This provision of the proposed treaty is based on the fiscal domicile article of the OECD model tax treaty and is similar to the provisions found in other U.S. tax treaties.

Under the treaty, a person (either an individual or an entity such as a partnership, estate or trust) is considered to be a resident of either country if, under the laws of that country, the person is resident for tax purposes. A partnership, estate, or trust will be considered to be a resident of either country only to the extent that the income it derives is subject to tax, either in its hands or the hands of its partners or beneficiaries, as the income of a resident of the country. A citizen of the United States is not automatically a resident of the United States under this definition and accordingly may not be entitled to the benefits of the treaty. For example, a citizen of the United States resident in a third country would not be entitled to reduced rates of tax on Egypt source income.

An individual whom both countries consider to be a resident according to their general rules for determining residence will be deemed for all purposes of the treaty to be a resident of the country in which he has his permanent home (where an individual dwells with his family), his center of vital interests (his closest economic and personal relations), his habitual abode, or his citizenship. If the residence of an individual cannot be determined by these tests, applied in the order stated, the competent authorities of the countries will settle the question by mutual agreement.

Article 4. Source of Income

The source of income rules establish the framework for the basic provisions of the treaty that one country may tax residents and corporations of the other country only on income from sources within the taxing country (provided, with certain exceptions, that the resident is not a citizen of the taxing country). The rules are also important because the U.S. foreign tax credit is limited to the U.S. tax on income from sources outside the United States. Several of the [9] source rules contained in the proposed treaty differ in some degree from the source rules provided in the Internal Revenue Code. Since the general rules of taxation contained in the proposed treaty (Article 6) provide that it will not be applied to increase a person's tax, a taxpayer is not bound to apply the rules described below where the treaty rules would increase his U.S. tax liability.

The proposed treaty provides that dividends will be treated as income from sources within a country if paid by a corporation of that country. However, the treaty provides two exceptions to this general rule. First, dividends paid by U.S. corporations whose activities take place solely or mainly in Egypt are to be treated as Egyptian source income and accordingly, the dividends may be taxed by Egypt under Article 11. This rule is similar to exceptions provided in the Internal Revenue Code for foreign corporations doing business in the United States. Second, dividends paid by an Egyptian corporation are to be treated as U.S. source income if for the prior three years at least 50 percent of that corporation's gross income was industrial or commercial profits attributable to a permanent establishment of the corporation in the United States. This rule differs from the comparable Internal Revenue Code provision (section 861(a)(2)(B)) in that if the test is met all of the dividend is treated as U.S. source income rather than the pro rata portion of gross income.

Interest will be treated as income from sources within a country only if paid by that country, a political subdivision or a local authority thereof, or by a resident of that country. However, interest paid on an indebtedness incurred in connection with a permanent establishment will be sourced in the country where the permanent establishment is situated. This exception permits one country, under the proper circumstances, to tax interest paid by a permanent establishment maintained in that country by a resident of the other country or by a resident of a third country. For example, if a resident of France has a permanent establishment in Egypt which borrows money from a resident of the United States, the interest paid by the Egyptian permanent establishment will be deemed to be from Egyptian sources and Egypt may therefore tax the interest payments. The United States will not under the Code (sec. 861(a)(1)(C) and (D)) impose its withholding tax on interest paid to nonresident alien individuals or foreign corporations by a foreign corporation having a trade or business in the United States unless the majority of the foreign corporation's gross income from all sources for the 3-year period preceding the payment of the interest was effectively connected with the conduct of a U.S. trade or business.

In addition, the source rule for interest paid by permanent establishments will operate to exempt interest from tax in the country of the payor's residence if the interest is paid to a resident of the other country by a permanent establishment situated in a third country (and the indebtedness was incurred in connection with the third country permanent establishment). This results from the restriction in Article 6 (General rules of taxation) that a resident of one country who is not a citizen of the other country may be taxed by the other country only on income from sources within that other country.

[10] The proposed treaty provides that royalties for the use of, or the rights to use, property or rights to which the royalty article (Article 13) applies will be treated as income from sources within a country only to the extent that such royalties are for the use of, or the right to use, the property or rights within that country.

Income (including mineral royalties) to which the provision relating to income from real property (Article 7) applies will be treated as income from sources within a country only if the real property (or, in the case of a mineral royalty, the underlying real property) is situated in that country.

Income from the rental of tangible personal (movable) property will be treated as income from sources within a country only to the extent that the income is for the use of such property in that country.

Income from the purchase and sale, exchange, or other disposition of intangible or tangible personal property (other than contingent gains to which the royalty article applies) will be treated as income from sources within a country only if such sale, exchange, or other disposition is within that country.

Income received by an individual for his performance of labor or personal services, whether as an employee or in an independent capacity, will be treated as income from sources within a country only to the extent that the services are performed in that country. Income from personal services performed aboard ships or aircraft operated by a resident of one country in international traffic will be treated as income from sources within that country if performed by a member of the regular complement of the ship or aircraft. However, compensation described in Article 21 (Government Functions) and social security payments (Article 20) will be treated as income from sources within the country making the payments.

Notwithstanding the rules described above, industrial or commercial profits attributable to a permanent establishment will be considered to be from sources within the country in which the permanent establishment is located. This rule also applies to passive income of the types described above in situations where the passive income is treated as industrial and commercial profits because it is effectively connected with the permanent establishment.

The source of any item of income not specified in this article will be determined by each country in accordance with its own law. However, if the source of any item of income under the laws of one country is different from its source under the laws of the other country, or if its source is not readily determinable under the laws of either, the competent authorities of the two countries may, in order to prevent double taxation or further any other purpose of the proposed treaty, establish a common source of the item of income for purposes of the proposed treaty.

Article 5. Definition of Permanent Establishment

The proposed treaty contains a definition of permanent establishment which generally follows the pattern of other recent U.S. income tax treaties and the OECD model tax treaty. The permanent establishment concept is one of the basic devices used in income tax treaties to avoid double taxation. Generally, a resident of one country is not taxable on its business profits by the other country unless those profits [11] are attributable to a permanent establishment of the resident in the other country. In addition, the permanent establishment concept is used to determine whether the reduced rates of, or exemptions from, tax provided for dividends, interest, and royalties are applicable, or whether those amounts will be taxed as business profits.

The proposed treaty provides that in general, a permanent establishment is a fixed place of business through which a resident of one country engages in industrial or commercial activities in the other country. The proposed treaty specifies that a permanent establishment may be a seat of management; a branch; an office; a factory; a workshop; a mine or quarry, or other place of extraction of natural resources; and the maintenance of any building site or construction or assembly project only if it solely exists for more than six months. This six-month period is shorter than the 12-month period provided in many treaties and in the U.S. model. It reflects Egypt's status as a developing country.

This general rule is modified to provide that a fixed place of business which is used solely for any or all of a number of specified activities will not constitute a permanent establishment. These activities include the use of facilities for storing, displaying, or delivering merchandise belonging to the resident; the maintenance of a stock of goods belonging to the resident for purposes of storage, display, delivery, or processing by another person, and the purchase of goods, collection of information, advertising, scientific research, or other auxiliary activities, for the resident. A resident of one country shall not be deemed to have a permanent establishment in the other country merely because the resident sells goods which were displayed at trade fairs or conventions in that other country. The trade fair exception is not intended to apply with respect to goods in the resident's inventory.

A resident of one country will be deemed to have a permanent establishment in the other country if it maintains an agent in the other country who has, and habitually exercises, a general contracting authority in that other country. This rule does not apply if the agent's authority is limited to the purchase of goods for his principle. The proposed treaty contains the usual provision that the agency rule will not apply if the agent is a broker, general commission agent or other agent of independent status acting in the ordinary course of its business.

The determination of whether a resident of one country has a permanent establishment in the other country is to be made without regard to the fact that the resident may be related to a resident of the other country or to a person who engages in business in that other country.

The article is to be applied to determine, where relevant, whether a resident of a third country has a permanent establishment in the U.S. or Egypt, or whether a resident of the United States or Egypt has a permanent establishment in a third country. This provision is relevant to determine the source of certain interest income. It does not extend the benefits of the treaty to third country residents.

Article 6. General Rules of Taxation

The proposed treaty contains the basic general rules of taxation which are found in most of our other tax treaties. In many treaties, however, these rules are not found in a separate article.

[12] A resident of one country may be taxed by the other country only on income from sources within that other country (which includes business profits only to the extent that are attributable to a permanent establishment in that other country). For this purpose, the source rules of Article 4 are to be applied.

The proposed treaty also contains the customary rule that it may not be applied to restrict any benefits under domestic tax rules. This reflects the general rule that a treaty does not work to increase the tax burden of residents of either country beyond what it would be in the absence of the treaty—that is, the treaty only applies where it benefits taxpayers. (See, for example, the discussion under Article 4 of the source of certain dividend income.)

The proposed treaty contains the usual "saving clause" by which the United States (or Egypt) reserves the right to tax its citizens and residents as if the treaty had not come in effect. However, this savings clause does not apply in several cases where its application would nullify specific policies contained in the proposed treaty which are designed to benefit residents and citizens. The principal exceptions involve social security payments, the foreign tax credit, the nondiscrimination provision and the mutual agreement procedure. The savings clause also does not affect the benefits provided to resident aliens under the provisions relating to diplomatic or consular officers or other governmental employees, teachers, and students, and trainees, provided they are not citizens of or do not have immigrant status in the country imposing the tax.

The treaty also authorizes the competent authorities to promulgate regulations to carry out the treaty. This power is also provided by U.S. law (sec. 7805).

Article 7. Income from Real Property

The United States generally taxes U.S. source income from real property earned by a foreign person not engaged in trade or business in the United States at 30 percent of the gross amount of the income. Gains on the sale or exchange of U.S. real property and certain interests in U.S. real property are taxed by the U.S. as business profits effectively connected with a U.S. business (sec. 897).

The proposed treaty retains the right of the United States and Egypt to tax income from real property by providing that income from real property may be taxed in the country where the real property is located. Income from real property includes income from the direct use or renting of the property and gains on the sale, exchange, or other disposition of the property. It also includes royalties and other payments in respect of the exploitation of natural resources (e.g., oil wells) and gains on the sale, exchange or other disposition of the royalty rights on the underlying natural resource. Mortgage interest is treated as income from real property under the proposed treaty.

The proposed treaty also provides that gains from the disposition of shares of a corporation or an interest in a partnership, estate, or trust is treated as real property income if the property of the entity consists principally of real property located in the United States or Egypt. This treatment of the sale of stock of a corporation is consistent with U.S. law. The treatment of a deposition of an interest in a [13] partnership, trust, or estate, however, is not. Under U.S. law (Code section 897) the disposition of an interest in a partnership, trust or estate is, to the extent attributable to a U.S. real property interest, considered to be a taxable sale of the real property. The treaty would change this rule by providing that the sale of an interest in such an entity is taxable by the country in which real property is located only if the property of the entity consists principally of real property located in that country. The Committee believes that the treatment accorded dispositions of U.S. real property interests by foreigners should be consistent with the Code unless good reasons are shown to change that treatment. This is particularly true here where the treaty was transmitted to the Senate only four weeks before the real property legislation was passed.

Accordingly, the Committee recommends a reservation that gains from the alienation of an interest in a partnership, trust or estate shall be regarded as income from real property to the extent attributable to real property or to the extent attributable to an interest therein, including any interest in shares of a corporation gain from the alienation of which would, under the law of the country in which the underlying real property is located be treated as income from real property. This treatment of dispositions of interests in partnerships, trusts or estates, is intended to be consistent with U.S. law.

Article 8. Business Profits

U.S. Code rates.—The United States taxes U.S. citizens, residents and corporations on their worldwide income. The United States taxes nonresident alien individuals and foreign corporations on their U.S. source income which is not effectively connected with the conduct of a trade or business in the United States. They are also taxed on their income which is effectively connected with the conduct of a trade or business in the United States whether that income is U.S. source or foreign source.

The taxation of income differs depending on whether it is effectively connected or not. Income which is effectively connected with the conduct of a trade or business in the United States is subjected to tax at the normal graduated rates on a net basis. Deductions are allowed in computing effectively connected taxable income, but only if and to the extent they are connected with income which is effectively connected.

Foreign source income is effectively connected income only if the foreign person has an office or other fixed place of business in the United States and the income is attributable to that place of business. Only three types of foreign source income can be effectively connected income; rents and royalties derived from the active conduct of a licensing business; dividends, interest, or gain from stock or debt derived in the active conduct of a banking, financing or similar business in the United States; and certain sales income attributable to a United States sales office.

Except in the case of a dealer, the trading in stocks, securities or commodities in the United States for one's own account does not constitute a trade or business in the United States and accordingly from those activities is not taxed by the U.S. as business income. This concept includes trading through a U.S. based employee, a resident broker, [14] commission agent, custodian or other agent or trading by a foreign person physically present in the United States.

Proposed treaty rules.—The treaty contains rules for the taxation of business profits that are similar to U.S. internal rules. Under the proposed treaty industrial and commercial profits of a resident of one country are taxable in the other country only to the extent they are attributable to a permanent establishment which the resident has in the other country. This provision is one of basic limitations on a source country's right to tax income of a nonresident.

In computing the taxable industrial and commercial profits, the deduction of expenses, wherever incurred, which are reasonably connected with the business profits are allowed. Deductible expenses include executive and general administrative expenses, interest, research and development expenses, and other expenses wherever incurred. Thus, for example, a U.S. company that has a branch in Egypt but has its head office in the United States will, in computing its Egyptian tax liability of the branch, be entitled to deduct a portion of the executive and general administrative expenses incurred in the United States by the head office for purposes of administering the Egyptian branch. However, in determining the amount of the deduction for head office expenses, the deduction may be limited to the expenses actually incurred by the head office without including a profit element.

The profits of a permanent establishment and determined on an arm's-length basis. Thus, there is to be attributed to it the industrial and commercial profits which would reasonably be expected to have been derived if it were an independent entity engaged in the same or similar activities under the same or similar conditions and dealing at arm's-length with the resident of which it is a permanent establishment. (See Code sec. 864(c).)

Industrial and commercial profits will not be attributed to a permanent establishment merely by reason of the purchase of merchandise by the permanent establishment (or by the resident of which it is a permanent establishment) for the account of that resident. Thus, where a permanent establishment purchases goods for its head office, the industrial and commercial profits attributed to the permanent establishment with respect to its other activities will not be increased by any profit element on its purchasing activities.

For purposes of the proposed treaty, the term "industrial or commercial profits" includes income derived from manufacturing, mercantile, banking, insurance, agricultural, fishing or mining activities, the operation of ships or aircraft, the furnishing of services, the rental of tangible personal (movable) property and the rental or licensing of motion picture films or films or tapes used for radio or television broadcasting. The term does not include income from the performance of personal services derived by an individual either as an employee or in an independent capacity. The proposed treaty follows the approach of our other recent tax treaties and the Internal Revenue Code by including within "industrial and commercial profits" investment income (income from dividends, interest, certain royalties, capital gains, and income derived from property and natural resources) where the income is effectively connected with a permanent establishment. (See Code sec. 864(c).)

[15] The proposed treaty also contains criteria for determining whether income is effectively connected with a permanent establishment. Factors to be taken into account include whether the rights or property giving rise to such income are used in (or held for use in) carrying on an activity giving rise to industrial or commercial profits through a permanent establishment and whether the activities carried on through such permanent establishment are a material factor in the realization of the income. The effectively connected concept in this paragraph is substantially similar to the effectively connected concept applied by the United States to all taxpayers under the Code (sec. 864(c)).

Where business profits include items of income which are dealt with in other articles, those other articles will govern the taxation of those items of income.

Article 9. Shipping and Air Transport

The proposed treaty exempts from tax in one country income which is derived by a resident of the other country from the operation of ships and aircraft in international traffic. Gains which are derived from the sale, exchange or other disposition of such ships or aircraft are covered by Article 14 (Capital Gains) and thus are generally exempt from tax by the nonresidence country. This exemption is somewhat broader than that previously provided in most U.S. tax treaties under which shipping and air transport income of a resident of one country is exempt by the other only if the ships or aircraft are registered in the first country. It conforms to the most recent treaties and to the current U.S. model.

Income from the operation in international traffic of ships or aircraft includes the rental income of ships or aircraft operated in international traffic if the rental income is incidental to income of the resident from the actual operation of ships or aircraft which would qualify for the exemption. For example, this rule permits an airline which is a resident of one country and which has excess equipment during certain periods to lease that excess equipment during those periods to an airline which is a resident of the other country.

The proposed treaty also makes clear that income derived from the use, maintenance, and lease of containers, trailers for the inland transport of containers, and other related container equipment in connection with the operation in international traffic of ships or aircraft is to be included within the scope of the shipping and air transport provision.

The proposed treaty makes clear that dividends from a corporation engaged in the operation of ships or aircraft are not covered by this article. Those dividends would be covered by the dividend article (Article 11).

The treaty also provides that the Decree of the Egyptian Council of Ministers (of November 23, 1955), which provides a limited exemption for U.S. air transport enterprises, is to cease to have effect upon entry into force of this convention, since the treaty contains a broader exemption provision.

Article 10. Related Persons

The proposed treaty, like most other U.S. tax treaties, contains a provision similar to section 482 of the Internal Revenue Code which recognizes the right of each country to make an allocation of income [16] in the case of transactions between related persons, if an allocation is necessary to reflect the conditions and arrangements which would have been made between unrelated persons.

It is anticipated that when a redetermination has been made by one country with respect to the income of a related person, the other country will attempt to reach an agreement with the first country in connection with the redetermination and, if it agrees with the redetermination, it will make a corresponding adjustment to the income of the other person.

Article 11. Dividends

The United States imposes a 30-percent tax (sometimes called a "withholding tax") on the gross amount of dividends paid to nonresident alien individuals and foreign corporations. The 30-percent tax does not apply if the recipient is engaged in a trade or business in the United States and the dividend is effectively connected with that trade or business.

The proposed treaty limits the rate of withholding tax imposed by the United States to 15 percent on dividends paid to Egyptian residents generally and to 5 percent on dividends paid to Egyptian corporations which have at least a 10-percent ownership interest in the paying corporation. The 5-percent withholding rate is not to apply (but the 15-percent rate will apply) where more than 25 percent of the paying corporation's gross income consists of interest and dividends other than interest derived in the conduct of a financial business or dividends or interest from a 50-percent or greater subsidiary (i.e., where the corporation is an investment company).

The proposed treaty contains no comparable reduction of Egyptian tax on dividends paid by Egyptian corporations to residents of the United States. Under the proposed treaty, dividends are subject to the tax on movable capital plus the defense tax, the national security tax, the war tax, the supplementary tax on any of the above taxes and any substantially similar taxes enacted after the treaty enters into force. These taxes are equivalent in the aggregate to the rate of corporate tax. To the extent dividends are paid out of current earnings, the paying corporation must be allowed a deduction from taxable income equal to the amount of the dividends. Thus, with respect to dividends out of current earnings only the dividend taxes apply. No deduction is required with respect to distributions out of accumulated earnings. These treaty provisions thus do not alter the rules of Egyptian law which would be applied in the absence of a treaty.

In the case of dividends paid by Egyptian corporations to individuals, Egypt levies the taxes described in the paragraph above with the same deduction rule. In addition, the treaty provides that the general income tax imposed under Egyptian law may be levied, but the average amount of general income tax imposed cannot exceed 20 percent of the net dividend payable for any year. Dividends paid to a U.S. corporation are subject to all of the taxes described above, but not the general income tax.

In accordance with the usual treaty rules, dividends which constitute industrial or commercial profits of a resident in one country attributable to a permanent establishment in the other country are to be treated as business profits (and taxed under Article 8) rather than as dividends. If the recipient of the dividend is a citizen of the [17] first country, that country would also tax the dividends under the saving clause.

The treaty contains special rules for branches of U.S. corporations which constitute permanent establishments in Egypt and for U.S. corporations which operate solely or mainly in Egypt. Under the treaty, dividends paid by these U.S. corporations and dividends deemed to be paid (under Egyptian law) by branches of U.S. corporations are also to be fully subject to the Egyptian taxes described above in connection with dividends paid to Egyptian corporations. These rules are also to apply only if an Egyptian corporate tax deduction is allowed to the U.S. corporation or branch for the amount of the dividend or deemed dividend paid. Thus, the same deduction rules that apply to a resident corporation apply to a branch. These rules reflect Egyptian law which taxes foreign corporations that earn most of their income in Egypt as Egyptian corporations. The U.S. has similar rules with respect to dividends paid by certain foreign corporations. (See sec. 861(a)(3)(B) and (C).)

The term "dividend" is defined as including income from certain shares that are not debt claims. It includes income on corporate rights that is subject to the same tax treatment as income from shares in the distributing corporation's country of residence.

Article 12. Interest

The United States imposes a 30-percent tax on U.S. source interest paid to foreign persons under the same rules that are applicable to dividends. U.S. source interest generally is interest paid on debt obligations of U.S. persons, but not interest on deposits in U.S. banks.

The proposed treaty generally limits the withholding tax in the source country on interest derived by a resident of one country from sources within the other country to 15 percent of the gross amount of interest paid.

The reduced rates of withholding tax on interest will apply unless the recipient has a permanent establishment in the source country and the interest is effectively connected with the permanent establishment. If the interest is industrial or commercial profits attributable to a permanent establishment then it will be taxes under the business profits provisions (Article 8) of the proposed treaty. This treatment generally conforms to that provided by other recent U.S. tax treaties and the U.S. and OECD model tax treaties.

Interest paid by a resident of one country to a person other than a resident of the other country (and, in the case of interest paid by a resident of Egypt, to a person other than a U.S. citizen) will be exempt from tax by the other country. However, this rule is inapplicable (1) if the interest is treated as income from sources within the other country under the proposed treaty's source of income rules or (2) if the recipient of the interest has a permanent establishment in the other country and the interest is effectively connected with the permanent establishment.

The proposed treaty also provides that interest derived beneficially by either country, or by a tax-exempt instrumentality of either country, will be exempt from tax by the other country. Under this rule income derived by the Export-Import Bank of the United States and the Overseas Private Investment Corporation (OPIC) on loans made to Egyptian residents will be exempt from tax by Egypt. This exemption also [18] applies where a resident of one country receives interest income on debt obligations guaranteed or insured by that country or an instrumentality of that country.

The proposed treaty defines the term interest in broad terms as income from money lent and any other income which the tax laws of the source country treat as income from money lent. Real estate mortgage interest and any other income treated as income from real estate under Article 7 is not interest. It is understood that this provision permits the United States to apply its rules for distinguishing between debt and equity (section 385) with the competent authorities settling disputes if conflicts between United States and Egyptian rules cause double taxation.

The proposed treaty deals with the question of non-arm's length interest payments in situations where the payor and recipient are related, by providing that the interest provision of the proposed treaty only applies to the amount of interest which would have been paid had the parties not been related. The excess might, for example, be treated as dividends subject to the provisions of Article 11.

Article 13. Royalties

Under the same system that applies to dividends and interest, the United States imposes a 30-percent tax on all U.S. source royalties paid to foreigners. Royalties are from U.S. sources if they are from property located in the United States including royalties for the use of or the right to use intangibles in the United States.

The proposed treaty provides for a reduction of source basis taxation at royalities derived by a resident of one country. Royalties derived by a resident of one country from sources within the other may be taxed by both countries, but the tax by the country of source is limited to 15 percent of the gross amount of the royalty. The source of a royalty is the country where the rights are used.

Royalties are defined in the proposed treaty as payments of any kind made as consideration for the use of, or the right to use, copyrights of literary, artistic, or scientific works, and payments of any kind made as consideration for the use of, or the right to use, patents, designs, models, plans, secret processes or formulas, trademarks, or other like property or rights. Payments made on copyrights of motion picture films or films or tapes used for radio or television broadcasting are not treated as royalties. Instead, they are commercial and industrial profits under Article 8. Royalties include gains derived from the sale, exchange, or other disposition of such property or rights to the extent the amounts received are contingent on the productivity use, or disposition of the property or rights. If the amounts realized are not contingent, the provisions of Article 14 (Capital Gains) may apply.

The reduced withholding rates do not apply where the recipient has a permanent establishment in the source country and the royalties are effectively connected with the permanent establishment. If the royalty is effectively connected with a permanent establishment, then it will be considered business profits of the permanent establishment subject to the rules of the business profits provisions (Article 8).

As in the case of the interest provisions, the royalty provision does not apply to that part of a royalty paid to a related person which is [19] considered excessive. In addition, the provision does not apply to dividends on stock issued under Egyptian law as consideration for royalty rights.

Article 14. Capital Gains

The United States generally exempts foreign persons from tax on their U.S. source capital gains. Gains from the disposition of U.S. real property and U.S. real property interests are taxed. (See discussion of Article 7.) The proposed treaty generally continues this treatment by providing that capital gains derived by a resident of one country will be exempt from tax by the other country. The exemption does not apply where an individual resident of one country is present in the source country for 183 days or more during the taxable year. Tax would also be imposed under the code in such a case. In addition, this provision does not apply to gains which are subject to the provisions relating to business profits (Article 8), income from real property (Article 7), and royalties (Article 13). In those cases, the gain may be taxed by the country in which the property is located.

Article 15. Independent Personal Services

Under U.S. law, the income of a nonresident alien from the performance of personal services is not taxed if the individual is not in the U.S. for at least 90 days, the compensation does not exceed $3,000, and the services are performed as an employee of a foreign person not engaged in a trade or business in the U.S. or they are performed for a foreign permanent establishment of a U.S. person. The United States taxes the income of a nonresident alien at regular rates if the income is effectively connected with the conduct of a trade or business in the United States by the individual. (See discussion of U.S. taxation of business profits under Article 8 (Business Profits).) The performance of personal services in the United States can be a trade or business within the United States (section 864(b)).

This article, and Article 16, limit a country's right to tax income earned by a resident of the other country from the performance of personal services.

Under the proposed treaty, income from the performance of independent personal services (i.e., services performed as an independent contractor, not as an employee) in one country by a resident of the other country is exempt from tax in the country where the services are performed, unless the person performing the personal service is present in the source country for 90 or more days during the taxable year. This provision is modified in the case of income derived by public entertainers (theater, motion picture, radio and television artists, musicians, and athletes) by Articles 17 and 18.

Article 16. Dependent Personal Services

Under the proposed treaty, income from services performed as an employee in one country (the source country) by a resident of the other country will not be taxable in the source country if four requirements are met: (1) the individual is present in the source country for less than 90 days during the taxable year; (2) the individual is an employee of a resident of, or a permanent establishment in, his country of residence; (3) the compensation is not borne by a permanent establishment of the employer in the source country; and [20] (4) the income is subject to tax in the country of residence. Income of a U.S. citizen which is excluded from income under the section 911 exclusion for income earned abroad thus does not qualify for the exemption from Egyptian tax.

Special rules are provided in Articles 21, 22 and 23 for government employees, teachers and students and trainees which, where applicable, take precedence over the general rules in this article.

Compensation derived by an employee aboard a ship or aircraft operated by a resident of one country in international traffic is exempt from tax by the other country, provided that the employee is a member of the regular complement of the ship or aircraft.

Article 17. Public Entertainers

The proposed treaty provides a special set of rules that apply to public entertainers and athletes. This proposed treaty provides that, nonwithstanding other provisions of the treaty dealing with personal services (Article 15. Independent Personal Services and Article 16. Dependent Personal Services), income derived by an individual resident of one country from his performance of personal services in the other country as a public entertainer, such as a theater, motion picture, radio or television artist, a musician or an athlete, may be taxed by the other country, but only if the gross amount of such income exceeds $400 for each day the individual is present in the other country for the purpose of performing such services therein. If the individual receives a lump sum payment for services performed on a number of days, the amount received will be prorated over the number of days on which the services are performed.

Article 18. Amounts Received for Furnishing Personal Services of Others

The proposed treaty contains a provision that allows the country where personal services are performed to tax income from the furnishing of the services under situations which have been viewed as an abuse of tax treaties. The purpose of this provision is to prevent individuals (generally residents of a third country) from using an entity of one country (for example, a corporation) to furnish services in the other country and thereby avoid payment of tax in either country.

Under the proposed treaty, amounts received by a resident of one country for furnishing in the other country the services of one or more individuals may be taxed by the country where the services are performed where the resident directly or indirectly compensates the person or persons who actually performed the services. This provision is to apply if the person for whom the services were rendered had the right (whether or not legally enforceable) to designate the person or persons who would render the services, or did in fact designate the person or persons, and the person performing the services is not a resident of either country who is subject to tax on the compensation. This provision is not to apply if it is established to the satisfaction of the competent authority of the source country that the organization furnishing the services was neither formed nor used in a manner which results in a substantial reduction on the income taxes from the furnishing of the services.

[21] This provision does not apply to a resident of one country if the person furnishing the services of others is resident in a third country. Accordingly, unlike some other U.S. treaties, it does not deal with certain abusive cases involving the use of tax haven entities by entertainers. In that case, the rules of Articles 15, 16, or 17 would apply to the person performing the services. The treaty does not deal with the third country supplier of the services.

Article 19. Private Pensions and Annuities

Under the proposed treaty, private pensions and other similar remuneration, alimony, and annuities derived from one country by residents of the other country are taxable only in the country of residence of the individual. Child support payments made by a resident of one country to a resident of the other are exempt in the recipient's country. Pensions generally include payments for past services, but not social security, which is covered by Article 20, or governmental pensions which are covered by Article 21.

Article 20. Social Security Payments

Under the proposed treaty, social security payments and other public pensions, including railroad retirement benefits, paid by one country to a resident of the other are to be taxed only in the country of residence. The article relating to termination of the treaty contains a special provision (Article 32(2)) allowing this Article to be terminated by either country at any time after the proposed treaty enters into force.

Article 21. Governmental Functions

Under the proposed treaty, wages, including pensions or similar benefits, paid by one country to an individual for labor or personal services performed for that country in the discharge of governmental functions is exempt from tax by the other country. This exemption does not apply if the individual performing the services is a citizen of, or acquires immigrant status in, the country where the services are performed. It applies only to amounts paid by the national government, and thus, in the case of the United States, does not apply to amounts paid by the States.

Any services performed in connection with a trade or business carried on by one of the countries are to be treated the same as services provided for private employers (for which Articles 16 and 19 apply).

Article 22. Teachers

The proposed treaty provides that a teacher or researcher who is a resident of one country will be exempt from tax in the other country on income from teaching or engaging in research in the host country if he is present in that country for a period not expected to exceed two years. The exemption only applies if the individual comes to the other country primarily for the purpose of teaching or engaging in research pursuant to an invitation of the host country or a recognized educational institution of the host country. It is not to apply with respect to income from research which is undertaken primarily for the benefit of a specific person or persons. If the teacher or researcher remains in the other country for a period exceeding two years, the exemption only applies to income earned during the 2-year period.

[22] *Article 23. Students and Trainees*

Under the proposed treaty, residents of one country who become students in the other country will be exempt from tax in the host country on gifts from abroad used for maintenance or study and on any grant, allowance or award. In addition, a $3,000 annual exemption from tax by the host country is provided for personal service income (such as income from a part-time job) derived from sources within the country in which the individual is studying.

These exemptions and the visiting teachers' exemption (Article 22) may only be utilized for a period of 5 years plus any additional period of time necessary to complete educational requirements as a candidate for a postgraduate or professional degree from a recognized institution. In addition, the benefits under the teacher's article are not available to an individual if, during the immediately preceding period, the individual received the benefit of the student provision.

In addition to the exemption regarding students, the proposed treaty follows the approach of other recent U.S. tax treaties and provides a limited exemption for personal service income of residents of one country who are employees of a resident of that country and who are temporarily present in the other country to study at an educational institution or to acquire technical, professional, or business experience. This exemption is available for a period of 12 consecutive months and is limited to $7,500. The proposed treaty also provides an exemption for income from personal services performed in connection with training, research, or study by residents of one country who are temporarily present in the other country as participants in Government-sponsored training programs. This exemption is limited to $10,000.

If an individual qualifies for the benefits of more than one of the provisions of this article and Article 22 (the visiting teachers exemption), the individual may choose the most favorable provision but may not claim the benefits of more than one provision in any taxable year. This provision does not apply to students or trainees who are citizens of, or who have acquired immigrant status in, the host country.

Article 24. Investment or Holding Companies

The proposed treaty contains a provision which denies the benefits of the dividends, interest, royalties, and capital gains articles to a corporation which is entitled in its country of residence to special tax benefits resulting in a substantially lower tax on those types of income than the tax generally imposed on corporate profits by that country. This provision only applies if more than 25 percent of the capital of the corporation is owned by nonresidents of that country. Thus, a dual test must be met in order for the provision to come into effect. A similar provision is contained in several recent U.S. tax treaties. The U.S. capital gain rates do not constitute special tax benefits.

This provision is intended to have broad application. Accordingly, the term capital should be broadly construed. It includes, for example, common and preferred stock, and convertible debt. It also applies if nonresidents have effective control over the requisite percentage of the capital of the company.

[23] The purpose of this provision is to prevent residents of third countries from using a corporation in one treaty country, which is preferentially taxed in that country, to obtain the tax benefits in the other treaty country which the proposed treaty provides for dividends, interest, royalties, and capital gains derived from that other country. Without this provision, residents of third countries could form an investment or holding company in one of the countries to take advantage of any special rates of tax for holding companies. This accords with the purpose of an income tax treaty between two countries to lessen or eliminate the amount of double taxation of income derived from sources within one country by a resident of the other country.

Article 25. Relief from Double Taxation

Under the proposed treaty, each country agrees to provide its citizens and residents with a foreign tax credit for the appropriate amount of income taxes paid to the other country. The credit allowed for U.S. tax purposes under this provision is subject to the provisions of U.S. law applicable to the year in question. Thus, the United States is not obligated to maintain a particular type of foreign tax credit. In the case of the United States, the amount of the credit is not to exceed the limitations (for the purpose of limiting the credit to the U.S. tax on income from sources within Egypt or on income from sources outside of the United States) provided by U.S. law for the taxable year. Thus, the credit would be subject to the limitations of sections 904 and 907 of the code. (The U.S. presently has an "overall" or worldwide foreign tax credit limitation.) The credit allowed by Egypt is limited to the amount of Egyptian tax attributable to income from sources within the United States.

The proposed treaty also provides that a deemed-paid foreign tax credit will be made available to a United States corporation with respect to dividends from an Egyptian corporation in which it has at least a 10-percent ownership interest. In this case, a credit will be allowed for the Egyptian corporate tax paid by the Egyptian corporation on the earnings out of which the dividend is paid. A deemed-paid foreign tax credit satisfying the treaty requirements is presently provided under the Internal Revenue Code. Similarly, the proposed treaty provides that Egypt is to provide a deemed-paid foreign tax credit for U.S. tax attributable to dividends received by Egyptian corporations from U.S. corporations in which they are 10-percent shareholders.

For the purpose of applying the U.S. foreign tax credit under the treaty in relation to taxes paid to Egypt, the rules set forth under Article 4 will be applied to determine the source of income.

The provision provides that the taxes designated in Article 1 as covered by the treaty will be creditable for U.S. purposes. Accordingly, Treasury regulations dealing with foreign taxes would no longer be relevant to the designated taxes, to the extent that they deal with whether the taxes paid are income taxes and thus creditable. However, since, under Article 6, a U.S. person's taxes cannot be increased by reason of the treaty a person or taxpayer may choose the Code foreign tax credit. In that case, the regulation would apply.

[24] *Article 26. Nondiscrimination*

The proposed treaty contains a comprehensive nondiscrimination provision relating to taxes imposed at all levels of government similar to provisions which have been embodied in other recent U.S. income tax treaties. One country cannot discriminate by imposing more burdensome taxes on its residents who are citizens of the other country, or on permanent establishments of residents of the other country, than it imposes on comparable taxpayers. This provision does not, however, require either country to grant to residents of the other country the personal allowances, reliefs, or deductions for taxation purposes on account of personal status or family responsibilities which it grants to its own residents. The nondiscrimination provision also applies to corporations of one country which are owned by residents of the other country.

The treaty contains two specific exceptions that reflect Egyptian tax laws. Egypt is not required to give to U.S. corporations the exemptions from Egyptian tax provided under Egyptian law for income earned outside of Egypt as insurance reserves of an Egyptian corporation and with respect to certain exempt distributions from Egyptian investment corporations (necessary to avoid double taxation within that country). In addition, an exception is provided for the provisions of Article 11 allowing Egypt to tax dividends from U.S. corporations operating solely or mainly in Egypt and to tax deemed dividends from Egyptian permanent establishments of U.S. corporations.

Egypt grants a tax exemption to certain businesses that make investments in Egypt. The exemption is generally applicable if the Egyptian corporation is controlled by a foreign corporation. The tax exemption is not applicable if the Egyptian corporation is controlled by individuals and the country in which these individuals are located taxes the income when distributed. The United States does tax the dividends and therefore it appears that Egyptian companies owned by individuals who are U.S. residents will be discriminated against when compared to residents of other countries.

The provision is not intended to override the right of the United States to tax foreign corporations on their dispositions of a U.S. real property interest because the effect of the provisions imposing the tax is not discriminatory, nor is it intended to permit foreign corporations to claim the benefit of U.S. provisions intended to eliminate U.S. double tax, such as the dividends received exclusion provided by section 243.

Article 27. Mutual Agreement Procedure

The proposed treaty contains the standard mutual agreement provision which authorizes the competent authorities of Egypt and the United States to consult together to attempt to alleviate individual cases of double taxation or cases of taxation not in accordance with the proposed treaty.

Under the proposed article, a resident or citizen of one country who considers that the action of the countries or any one of them will cause him to pay a tax not in accordance with the convention may present his case to the competent authority of the country of which he is a resident or citizen. The competent authority then makes a determination as to whether or not the claim has merit. If the claim does have [25] merit, that competent authority endeavors to come to an agreement with the competent authority of the other country to limit the taxation which is not in accordance with the provisions of the treaty.

A second provision directs the competent authorities to resolve any difficulties or doubts arising as to the application of the convention. Specifically, they are authorized to agree to the attribution of profits to a resident of one country and its permanent establishment in another country, the allocation of income, deductions or credits, the determination as to source of income, and the characterization of items of income.

The treaty authorizes the competent authorities to communicate with each other directly for purposes of reaching an agreement in the sense of the mutual agreement provision. It also authorizes them to meet together for an oral exchange of opinions. These provisions make clear that it is not necessary to go through normal diplomatic channels in order to discuss problems arising by the application of the convention and also removes any doubt as to problems which might arise by reason of the confidentiality rules of the United States or Egypt.

Finally, the provision provides for the waiver of the statute of limitations of either country so as to permit the issuance of a refund or credit. The provision, however, does not authorize the imposition of additional taxes after the statute of limitations has run.

Article 28. Exchange of Information

This article forms the basis for cooperation between the two states to attempt to deal with avoidance or evasion of their respective taxes and to enable them to obtain information so that they can properly administer the convention. The proposed treaty provides for the exchange of information which is necessary to carry out the provisions of the proposed treaty or for the prevention of fraud or for the administration of statutory provisions concerning taxes to which the convention applies. The exchange is limited, however, to information that could be obtained under the laws and administrative practices of each of the countries with respect to its own taxes.

It is understood that a requested country will use its subpoena or summons powers or any other powers that it has under its own laws to collect information requested by the other country, even though it itself does not need that information for its own purposes. It is intended that the requested country may use those powers even if the requesting country could not under its own laws. Thus, it is not intended that provision be strictly reciprocal. For example, once the U.S. Internal Revenue Service has referred a case to the Justice Department for possible criminal prosecution, the United States investigators can no longer use an administrative summons to obtain information. If, however, Egypt could still use administrative process to obtain requested information, it would be expected to do so even though the U.S. cannot. The United States could not, however, tell Egypt which of its procedures to use.

Under the provision dealing with taxes covered, the exchange of information article applies to all taxes imposed at the national level even though those taxes are not otherwise covered by the proposed treaty. The information may apply to tax compliance generally and not merely to avoidance or evasion of tax.

[26] Information exchanged is to be treated as secret except that it may be disclosed to any person concerned with, or made a part of a public record with respect to, the assessment, collection, or enforcement of, or litigation concerning, the taxes to which the treaty applies. The Committee understands that there is a question as to whether, under the language of the treaty, the Congress, in the exercise of its oversight responsibilities, could obtain the information exchanged under the treaty. The Committee believes that such access is permitted, and is recommending that the treaty be approved subject to an understanding that such access is permitted.

The treaty provides that no information may be exchanged if the exchange would be contrary to public policy. Where specifically requested, the information must be provided in authenticated form including the form of deposition of witnesses and copies of unedited original documents (including books, papers, statements, records, accounts or writings), to the extent that such authenticated documents can be obtained under the laws of and administrative practices of the two countries. The provision specifically overrides any doctrine of law under which international judicial assistance is not accorded in tax matters. The provision is made for an exchange of information on a routine basis as well as with reference to particular cases.

Article 29. Assistance in Collection

The provision requires that each country aid in collecting the taxes of the other country to the extent necessary to insure that treaty benefits are not enjoyed by persons not entitled to their benefit. A country is not obligated to carry out measures contrary to its laws or administrative procedures.

Article 30. Diplomatic and Consular Officials

The proposed treaty contains the rule found in other U.S. tax treaties that its provisions are not to affect the fiscal privileges of diplomatic and consular officials under the general rules of international law or the provisions of special agreements.

Article 31. Entry into Force

The proposed treaty will enter into force 30 days following the exchange of the instruments of ratification. It will become effective with respect to withholding tax rates on the first day of the second month following the date on which the proposed treaty enters into force. With respect to all other taxes, it will become effective for taxable years beginning on or after January 1st of the year following the date on which the proposed treaty comes into force.

Article 32. Termination

The proposed treaty will continue in force indefinitely, but either country may terminate it at any time after 5 years from its entry into force by giving at least 6 months' prior notice through diplomatic channels. If terminated, the termination will be effective with respect to income of taxable years beginning (or, in the case of withholding taxes, payments made) on or after January 1 next following the expiration of the 6-month period. The provisions of Article 20 (social security payments) may be terminated by either country at any time after the proposed treaty enters into force by prior notice given through diplomatic channels.

[27] IX. TEXT OF THE RESOLUTION OF RATIFICATION

Resolved, (two-thirds of the Senators present concurring therein), That the Senate advise and consent to the ratification of the Convention with the Arab Republic of Egypt for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, signed at Cairo on August 24, 1980 (Ex. U, 96th Congress, 2nd Session), subject to the following:

(1) understanding that appropriate Congressional committees, and the General Accounting Office shall be afforded access to the information exchanged under this treaty where such access is necessary to carry out their oversight responsibilities, subject only

to the limitations and procedures of the Internal Revenue Code.

(2) reservation that notwithstanding the provisions of paragraph (3) of Article 7 of the convention (which relates to the taxation of gains from the alienation of shares of a corporation or of an interest in a partnership, estate, or trust, the property of which consists, directly or indirectly, principally of real property situated in one of the countries), gain derived by a resident of a Contracting State, from the alienation or other disposition of an interest in a corporation, or an interest in a partnership, trust, or estate, which has an interest in real property located in the other Contracting State, or the assets of which are considered under the domestic law of that other Contracting State to consist, in whole or in part, of real property, or an interest therein, in that other State, may be taxed by that other State to the extent provided for by its domestic law. In addition, gain derived by a corporation which is a resident of a Contracting State upon the distribution (including a distribution in liquidation or otherwise) of an interest in real property (as determined under the domestic law of the other Contracting State) may be taxed by that other Contracting State to the extent provided for its domestic law.

TECHNICAL EXPLANATION [1] OF THE CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE ARAB REPUBLIC OF EGYPT FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME SIGNED AT CAIRO ON AUGUST 24, 1980 [2]

INTRODUCTION

This is a technical explanation of the Convention between the United States and Egypt, signed on August 24, 1980 ("the Convention"). This explanation is an official guide to the Convention. It reflects policies behind particular Convention provisions, as well as understandings reached with respect to the interpretation and application of the Convention.

Article 1. TAXES COVERED

Paragraph (1) designates the taxes of the Contracting States which are the subject of the Convention. With respect to the United States, the subject taxes are the Federal income taxes imposed by the Internal Revenue Code ("Code"). The United States taxes imposed under Code sections 531 (accumulated earnings tax) and 541 (personal holding company tax) are excluded, thus preserving for the United States the right to impose these taxes.

United States taxes not generally covered by the Convention include the estate, gift, and generation skipping transfer taxes, the Windfall Profits Tax, Federal unemployment taxes and social security taxes imposed under sections 1401, 3101 and 3111 of the Code.

In the case of Egypt, paragraph (1) provides that the Convention applies to the tax on income derived from immovable property (including the land tax, the building tax and the ghaffir tax); the tax on income from movable capital; the tax on commercial and industrial profits; the tax on wages, salaries, indemnities and pensions; the tax on profits from liberal professions and all other noncommercial professions; the general income tax; the defense tax; the national security tax; the war tax; and all supplementary taxes imposed as a percentage of any of the previously mentioned taxes.

Pursuant to paragraph (2), the Convention will also apply to taxes substantially similar to those covered by paragraph (1) which are imposed in addition to, or in place of, existing income taxes, after August 24, 1980, (the date of signature of the Convention).

Under paragraph (3), for purposes of Article 26 (Nondiscrimination), the Convention applies to taxes of every kind imposed at the national, state, or local level; and for purposes of Article 28 (Exchange of Information), the Convention applies to taxes of every kind imposed at the national level.

Paragraph (4) provides that the competent authority of each Contracting State will promptly notify the competent authority of the other Contracting State of any amendment of the tax laws referred to in paragraph (1), or of the adoption of substantially similar taxes imposed in addition to, or in place of, those taxes by transmitting the texts of such amendments or statutes. Paragraph (5) provides for a similar exchange with respect to the publication of official material concerning the application of the Convention, whether in the form of regulations, rulings or judicial decisions.

Article 2. GENERAL DEFINITIONS

Paragraph (1) sets out definitions of certain basic terms used in the Convention. Unless the context otherwise requires, a term defined in this paragraph has a uniform meaning throughout the Convention. A number of important terms, however, are defined elsewhere in the Convention.

The term "United States" means the United States of America. When used in a geographical sense, the term means the states of the United States and the District of Columbia. Thus, the Convention does not apply to the possessions of the United States or the Commonwealth of Puerto Rico. The term "Egypt" means the Arab Republic of Egypt.

When used in a geographical sense, the terms "United States" and "Egypt" also include their respective territorial seas, and in general accord with the principles of section 638 of the Code, their respective continental shelves.

The term "Contracting State" is defined to mean the United States or Egypt as the context requires. The term "State" means the United States, Egypt, or any other national State.

---

[1] It is the practice of the Treasury Department to prepare for the use of the Senate and other interested persons a Technical Explanation of the tax conventions which are submitted to the Senate for its advice and consent to ratification.

An Income Tax Convention with the Arab Republic of Egypt was signed on August 24, 1980, and submitted by the President to the Senate on November 12, 1980. On September 24, 1981, the Senate Committee on Foreign Relations held hearings and this Technical Explanation was presented. The Senate voted its advice and consent on November 18, 1981, and instruments of ratification were exchanged on December 1, 1981.

[2] Page 219; pertinent excerpts from Senate Executive Report No. 97-27, page 230; Senate Executive D is not published.

The term "person" includes an individual, a partnership, a corporation, an estate or a trust.

The term "United States corporation" is defined as a corporation, or any unincorporated entity which is treated as a corporation for United States tax purposes, which is created or organized under the laws of the United States, any state thereof, or the District of Columbia. An "Egyptian corporation" is defined as a corporation, or any unincorporated entity which is treated as a corporation for Egyptian tax purposes, which is created or organized under the laws of Egypt.

With respect to the United States, the term "competent authority" means the Secretary of the Treasury or his delegate. With respect to Egypt, it means the Minister of Finance or his delegate. The term "tax" means those taxes imposed by the United States or Egypt to which the Convention applies by virtue of Article 1 (Taxes Covered).

The term "international traffic" is defined as any voyage of a ship or aircraft operated by a resident of one of the Contracting States except where such voyage is confined solely to places within a Contracting State. Thus, for example, coastal shipping along the Atlantic coast of the United States is not a voyage in international traffic. However, if a ship operated by a resident of Egypt transports goods from Canada to the United States, leaving some of the goods in New York and the remainder in Norfolk, the portion of the voyage between New York and Norfolk is internatinal traffic.

Paragraph (2) provides that any term used in the Convention which is not defined therein shall, unless the context otherwise requires, have the meaning which it has under the laws of the Contracting State whose tax is being determined. However, where a term has a different meaning under the laws of Egypt and the United States, or where the meaning under the laws of one of the Contracting States is not readily determinable, the competent authorities may for purposes of the Convention establish a common meaning, which may differ from the meaning under the laws of either Contracting States, in order to prevent double taxation or to further any other purpose of the Convention.

Article 3. FISCAL RESIDENCE

This article sets forth rules for determining the residence of individuals, corporations, and other persons for purposes of the Convention. Residence is important because, in general, only a resident of one of the Contracting States may qualify for the benefits of the Convention. The Convention definition is, of course, exclusively for purposes of the Convention.

Under paragraph (a), the term "resident of Egypt" means an Egyptian corporation (as defined in paragraph (1)(f)(ii) of Article 2 (General Definitions)) or any other person (except a corporation or any entity treated under Egyptian law as a corporation) resident in Egypt for purposes of Egyptian tax. Similarly, "resident of the United States" means a United States corporation (as defined in paragraph (1)(f)(i) Article 2 (General Definitions)) and any other person (except a corporation or any entity treated as a corporation for United States tax purposes) resident in the United States for purposes of United States tax. Thus, a resident of the United States includes a resident alien individual, an alien present in the United states who elects to be treated as a resident under Code section 6013(g) or (h), and a resident citizen, but under no circumstances, a foreign corporation. A citizen of the United States or Egypt is not automatically a resident of the United States or Egypt for purposes of the Convention. Residence for this purpose is to be determined in accordance with the principles of Treasury regulations under section 871 of the Code.

The Convention provides that a partnership, estate, or trust is a resident of a Contracting State only to the extent that the income derived by such person is subject to tax in such Contracting State as the income of a resident. For example, under United States law, a partnership is never, and an estate or trust is often not, taxed as such. Under the Convention, in the case of the United States, income received by a partnership, estate, or trust will not qualify for the benefits of the Convention unless such income is subject to tax in the United States as the income of a resident. Thus, in effect, the treatment of income received by a partnership will be determined by the residence and taxation of its partners with respect to that income. To the extent that partners are subject to United States tax as residents of the United States, the partnership will be treated as a resident of the United States. Similarly, the treatment of income received by a trust or estate will be determined by the residence and taxation of the person subject to tax on such income, which may be the grantor, the beneficiaries or the trust or estate itself, as the case may be.

An individual who is a resident of one Contracting State under its laws and is not a resident of the other need look no further to determine his residence under the Convention. However, where he is a resident of each Contracting State under its laws, paragraph (2) of the Article must be used to determine that person's residence under the Convention.

Under paragraph (2), an individual who is a resident of both Contracting States under paragraph (1) will be deemed to be a resident of the Contracting State in which he has his permanent home, his center of vital interests (closest personal and economic relations), an habitual abode, or his citizenship, in the order listed. If the issue is not settled by these tests, the competent authorities will decide by mutual agreement the one Contracting State of which he will be considered to be a resident.

Article 4. SOURCE OF INCOME

This article contains the source rules which are to be used in applying the provisions of the Convention. For example, under Article 6 (General Rules of Taxation), one Contracting State may tax a resident of the other Contracting State only on income from sources within the first-mentioned Contracting State (provided, with certain exceptions, such resident is not a citizen of the first-mentioned Contracting State).

Paragraph (1) provides that, as a general rule, dividends will be treated as income from sources within a Contracting State only if paid by a corporation of the Contracting State. This general rule will not apply in two cases. First, dividends paid by a United States corporation will be treated as income from sources within Egypt if such corporation's activities lie solely or mainly in Egypt and the dividend is taxed in Egypt in the manner prescribed in paragraphs (3) and (5) of Article 11 (Dividends). This rule is similar to that of Code sections 861(a)(2)(A) and 862(a)(1). See the explanation of paragraph (5) of Article 11 (Dividends) for a discussion of the effects of this rule. Second, dividends paid by a corporation other than a United States corporation will be treated as income from sources within the United States if at least 50 percent of such corporation's gross income from all sources for the 3-year period (or such part of that period as the corporation has been in existence) ending with the close of its taxable year preceding the declaration of the dividend was industrial or commercial profits attributable to a permanent establishment which such corporation had in the United States. The rule in the second case, though similar, differs from that of Code section 861(a)(2)(B) in that, for example, it does not specifically provide that only a pro rata portion of the dividend will be treated as income from sources within the United States. However, since Article 6 (General Rules of Taxation) provides, in effect, that the Convention will not increase a person's United States tax, the pro ration specified in Code section 861(a)(2)(B) will be applied to determine the portion of the dividend paid by such non-United States corporation which will be treated as United States source income.

Under paragraph (2), interest will be treated as income from sources within a Contracting State only if paid by the Contracting State, a political subdivision or a local authority thereof, or by a resident of the Contracting State. However, if interest is paid on an indebtedness incurred in connection with a permanent establishment which bears such interest, (i.e., deducts the interest in computing the income of the permanent establishment) then such interest shall be deemed to be from sources within the State (whether or not a Contracting State) in which the permanent establishment is situated. This exception permits a Contracting State, under the proper circumstances, to impose a tax on interest paid by a permanent establishment of a resident of a State other than a Contracting State. For example, if a resident of France has a permanent establishment in Egypt which borrows money from a resident of the United States and bears the interest, the interest will be deemed to be from Egyptian sources. Thus, Egypt may tax such interest, subject to the limitation of Article 12 (Interest). As provided in paragraph (8) of Article 5 (Permanent Establishment) the principles of Article 5 will be applied to determine whether the resident of France has a permanent establishment in Egypt. The United States will not, because of sections 861(a)(1)(C) and (D) of the Code, impose a tax on interest received by nonresident alien individuals or foreign corporations from a foreign corporation having a permanent estabishment in the United States unless 50 percent or more of the gross income of such corporation from all sources for the three year period ending with the close of its taxable year preceding the payment of the interest (or such part of such period as the corporation has been in existence) was effectively connected with the conduct of a trade or business within the United States. If it is, the U.S. will impose a tax on a pro rata portion of the interest.

In addition, the exception to the general rule of paragraph (2) of this article will exempt interest from tax in the Contracting State in which the payor resides if the payor has a permanent establishment in a State other than a Contracting State in connection with which the indebtedness on which the interest is paid was incurred, such interest is borne by the permanent establishment and such interest is paid to a resident of the other Contracting State. This results from the restriction in Article 6 (General Rules of Taxation) that a resident of one Contracting State, not a citizen of the other Contracting State, may be taxed by the other Contracting State only on income from sources within that other Contracting State.

Paragraph (3) provides that royalties for the use of, or the right to use, property or rights described in paragraph (2) of Article 13 (Royalties) will be treated as income from sources within a Contracting State only to the extent that such royalties are for the use of, or the right to use, such property or rights within that Contracting State.

Paragraph (4) provides that income and gains (including royalties) to which Article 7 (Income from Real Property) applies will be treated as income from sources within a Contracting State only if the real property is situated in that Contracting State. As noted in Article 7, paragraph (4) determines not only the source of a gain from the alienation of real property itself, but also of gains from the alienation of shares of a corporation, or of an interest in a partnership, estate, or trust the property of which consists principally of real property situated in a Contracting State.

Paragraph (5) provides that income from the rental of tangible personal (movable) property will be treated as income from sources within a Contracting State only if such property is situated in that Contracting State.

Under paragraph (6) income from the purchase and sale, exchange, or other disposition of intangible or tangible personal property (other than gains described in paragraph (2) of Article 13 (Royalties)) will be treated as income from sources within a Contracting State only if such sale, exchange, or other disposition is within that Contracting State.

Under paragraph (7), income received by an individual for his performance of labor or personal services, whether as an employee or in an independent capacity, will be treated as income from sources within a Contracting State only to the extent that such services are performed in that Contracting State. Income from personal services performed aboard ships or aircraft operated by a resident of a Contracting State in international traffic will be treated as income from sources within that Contracting State if rendered by a member of the regular complement of the ship or aircraft. However, remuneration described in

Article 21 (Governmental Functions), and payments described in Article 20 (Social Security Payments) paid from the public funds of a Contracting State or political subdivision or local authority thereof will be treated as income from sources within that Contracting State only.

Paragraph (8) contains a general qualification to the preceding source rules. It provides that industrial or commercial profits attributable to a permanent establishment which the recipient, a resident of one Contracting State, has in the other Contracting State will be treated as income from sources within that other Contracting State. Industrial or commercial profits attributable to such permanent establishment may include any item of income described in paragraphs (1) through (6) if the item of income is "effectively connected" with the permanent establishment. See the discussion of paragraph (6) of Article 8 (Business Profits) for a discussion of the effectively connected concept.

Under paragraph (9), the source of any item of income not described in the preceding paragraphs of Article 4 will be determined by each Contracting State in accordance with its own law. However, if the source of any item of income under the laws or one Contracting State is different from its source under the laws of the other Contracting State or if its source is not readily determinable under the laws of one of the Contracting States, the competent authorities of the Contracting State may, in order to prevent double taxation or further any other purpose of the Convention, establish a common source of the item of income for purposes of the Convention. (See paragraph (2)(C) of Article 27 (Mutual Agreement Procedure)).

Several of the source rules set out in this article differ to some degree from those provided in the Code. Since Article 6 (General Rules of Taxation) provides, in effect, that the Convention will not increase a person's overall United States tax, a taxpayer is not required to apply the Convention rules in calculating his United States tax liability. However, a taxpayer may not make inconsistent choices between Code and Convention rules.

Article 5. PERMANENT ESTABLISHMENT

This article defines the term "permanent establishment." The existence of a permanent establishment is relevant under Article 8 (Business Profits) to the taxation of industrial or commercial profits and in determining the applicability of other provisions of the Convention.

Under paragraph (1), the term "permanent establishment" means a fixed place of business through which a resident of one of the Contracting States engages in industrial or commercial activity. Illustrations in paragraph (2) of a permanent establishment include a seat of management; a branch; an office; a factory; a workshop; a mine, quarry or other place of extraction of natural resources; and the maintenance of a building site or construction or installation project which exists for more than six months. A drilling rig is included within this rule. Under the construction or installation project rule the six month period begins only when work physically commences in the other Contracting State. A series of contracts or projects which are interdependent both commercially and geographically is to be treated as a single project for the purpose of applying the six months test. As a general rule, any fixed facility or premises through which a resident conducts industrial or commercial activity for an indefinite or substantial period of time will be treated as a permanent establishment unless it is used only for one or more of the activities described in paragraph (3).

Paragraph (3) specifically provides that a permanent establishment does not include a fixed place of business if it is used only for one or more of the following:

"(a) The use of facilities for the purpose of storage, display, or delivery of goods or merchandise belonging to the resident;

"(b) The maintenance of a stock of goods or merchandise belonging to the resident for the purpose of storage, display, or delivery;

"(c) The maintenance of a stock of goods or merchandise belonging to the resident for the purpose of processing by another person;

"(d) The maintenance of a fixed place of business for the purpose of purchasing goods or merchandise, or for collecting information, for the resident;

"(e) The maintenance of a fixed place of business for the purpose of advertising, or for similar activities which have a preparatory or auxiliary character, for the resident; and

"(f) The maintenance of a building site or construction or installation project which does not exist for more than 6 months."

As noted, these exceptions are cumulative and a fixed place of business used only for one or more of these purposes will not be considered a permanent establishment under the Convention.

Under paragraph (4), a person acting in one Contracting State on behalf of a resident of the other Contracting State, other than an agent of an independent status to whom paragraph (5) applies, will be deemed to constitute a permanent establishment if such person has, and habitually exercises in that first-mentioned Contracting State, an authority to conclude contracts in the name of the resident, unless the exercise of the authority is limited to the purchase of goods or merchandise for the resident.

On the other hand, paragraph (5) provides that a resident of one Contracting State will not be deemed to have a permanent establishment in the other Contracting State merely because such resident engages in industrial or commercial activity in such other Contracting State through a broker, general commission agent, or any other agent of an independent status, where such broker or agent is acting in the ordinary course of his business.

Paragraph (6) provides that a resident of one Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because such resident sells at the termination of a trade fair or convention in the other Contracting State goods or merchandise which were displayed by such resident at the trade fair or convention. The trade fair exception is not intended to apply with respect to goods in the resident's inventory.

Under paragraph (7), the determination of whether a resident of one Contracting State has a permanent establishment in the other Contracting State is to be made without regard to the fact that such resident may be related to a resident of the other Contracting State or to a person who engages in business in that other Contracting State (whether through a permanent establishment or otherwise). As defined in Article 10 (Related Persons), a person is related to another person if either person owns or controls directly or indirectly the other, or if a third person or persons own or control directly or indirectly both.

Paragraph (8) provides that the principles set forth in this article are to be applied in determining whether there is a permanent establishment in a State other than one of the Contracting States or whether a person other than a resident of one of the Contracting States has a permanent establishment in one of the Contracting States. This is necessary for the proper application of paragraph (2) of Article 4 (Source of Income). This paragraph is not intended to extend the benefits of the Convention to persons other than residents of the two Contracting States.

Article 6. GENERAL RULES OF TAXATION

Under paragraph (1), a resident of one Contracting State may be taxed by the other Contracting State on any income from sources within that other Contracting State and only on such income, subject to the limitations set forth in the Convention. For this purpose, the source rules contained in Article 4 (Source of Income) are to be applied. However, if the resident is a citizen of the other Contracting State, that Contracting State may tax the resident without regard to this paragraph because of the saving clause of paragraph (3) of this article.

Paragraph (2) contains the customary rule that the Convention will not restrict in any manner any exclusion, exemption, deduction, credit, or other allowance now or hereafter accorded by the laws of a Contracting State in the determination of a tax imposed by it, or by any other agreement between the Contracting States. Thus, if a deduction would be allowed under the Code for any item in computing the taxable income of an Egyptian resident, such deduction is generally available to such person in computing taxable income under the Convention. Paragraph (2) does not, however, authorize a taxpayer to make inconsistent choices between rules of the Code and rules of the Convention. In no event may the Convention increase the overall tax burden on residents of the Contracting States. Thus, a right to tax given by the Convention cannot be exercised unless that right also exists under the Code.

Paragraph (3) contains the traditional saving clause under which the United States reserves the right to tax its citizens and residents as if the Convention had not come into effect. However, because of paragraph (4), the saving clause does not apply in several cases in which its application would contravene policies reflected in the Convention which are specifically designed to extend treaty benefits to citizens or residents. Thus, the saving clause does not affect the provisions with respect to child support, social security payments, relief from double taxation, nondiscrimination, or the mutual agreement procedure. Moreover, the saving clause does not affect the benefits of the Convention granted to individuals performing governmental functions, teachers, students, trainees, and diplomatic or consular officers who are neither citizens of, nor have immigrant status in, the Contracting State imposing the tax. In the case of the United States, "immigrant status" means the individual has been admitted to the United States for permanent residence. The saving clause is reciprocal.

Paragraph (5) authorizes the competent authorities of the Contracting State to prescribe regulations necessary to carry out the provisions of the Convention. For the United States, this authority is also provided by section 7805 of the Code.

Article 7. INCOME FROM REAL PROPERTY

Under paragraph (1), income from real property, including royalties and other payments in respect of the exploitation of natural resources (e.g., oil wells), gains from the sale, exchange or other disposition of such property or the right giving rise to such royalties or other payments, and interest on indebtedness secured by real property (e.g., mortgages) or secured by a right giving rise to royalties or other payments in respect of the exploitation of natural resources, may be taxed by the Contracting State in which the real property or natural resources are situated. Thus, natural resource royalties are covered under this Article and not under Article 13 (Royalties).

Under paragraph (2), paragraph (1) applies to income derived from the usufruct, direct use, letting, or use in any other form of real property.

Paragraph (3) provides, consistent with U.S. law, that gains from the alienation of shares of a corporation or of an interest in a partnership, estate, or trust, the property of which consists, directly or indirectly, principally of real property situated in a Contracting State, shall be regarded as income from real property. Thus, under paragraph (1) of the Article, such gains may be taxed in the Contracting State in which the real property is situated, and under paragraph (4) of Article 4 (Source of Income), the gain is treated as having its source in that State.

Paragraph (4) emphasizes what is clearly implied in paragraph (1), that income from real property (including that referred to in paragraph (3)) may be taxed by both the State of residence and the State in which the real property is situated.

This Article does not contain a provision allowing for the taxation of real property income on a net basis. This is because such treatment is already provided for under the laws of both Contracting States.

Article 8. BUSINESS PROFITS

Paragraph (1) sets forth the general rule that industrial or commercial profits of a resident of one Contracting

State are exempt from tax by the other Contracting State unless the resident has a permanent establishment in the other Contracting State. Where there is a permanent establishment, only the industrial or commercial profits attributable to the permanent establishment can be taxed by the other Contracting State, unless the resident is a citizen of that other Contracting State. (See the saving clause in paragraph (3) of Article 6 (General Rules of Taxation)). Under paragraph (8) of Article 4 (Source of Income), industrial or commercial profits whether from sources within or without a Contracting State attributable to a permanent establishment which a resident of one Contracting State has in the other Contracting State will be considered to be from sources within that other Contracting State. Thus, items of income described in section 864(c)(4)(B) of the Code attributable to a permanent establishment situated in the United States will be subject to tax by the United States. The limited "force of attraction" rule under Code section 864(c)(3) does not apply for U.S. tax purposes under the Convention.

In determining the proper attribution of industrial or commercial profits under the Convention, paragraph (2) provides that both Contracting States will attribute to the permanent establishment such profits as it would reasonably be expected to derive if it were an independent entity engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the resident of which it is a permanent establishment. Under paragraph (3), expenses, wherever incurred, which are reasonably connected with profits attributable or apportionable to the permanent establishment, including executive and general administrative expenses, will be allowed as deductions in determining the industrial or commercial profits of the permanent establishment. However, in determining the amount of the deduction under paragraph (3) for expenses incurred by the head office, the deduction generally will be limited to the appropriate share of the expense incurred without including a profit element for the head office.

Paragraph (4) provides that no profits shall be attributed to a permanent establishment merely because of the purchase of goods or merchandise by that permanent establishment, or by the resident of which it is a permanent establishment, for the account of such resident. Paragraph (2) of the article does not override paragraph (4). Thus, where a permanent establishment purchases goods for its head office, the industrial and commercial profits attributed under paragraph (2) to the permanent establishment with respect to its other activities will not be increased by adding a notional figure for profits from purchasing.

Under paragraph (5), the term "industrial or commercial profits" includes income derived from manufacturing, mercantile, banking, insurance, agricultural, fishing or mining activities, the operation of ships or aircraft, the furnishing of services, the rental of tangible personal (movable) property, and the rental or licensing of motion picture films or films or tapes used for radio or television broadcasting. The term does not include income from the performance of personal services derived by an individual either as an employee or in an independent capacity.

Under paragraph (6) of this article, the term "industrial and commercial profits" also includes income from dividends, interest, royalties described in paragraph (2) of Article 13 (Royalties), and capital gains and income derived from property and natural resources, but only if the income is effectively connected with a permanent establishment. See paragraph (4) of Article 11 (Dividends), paragraph (5) of Article 12 (Interest), paragraph (3) of Article 13 (Royalties) and paragraph (1)(c) of Article 14 (Capital Gains).

Paragraph (6) also contains criteria for determining whether income is effectively connected with a permanent establishment. Factors to be taken into account include whether the rights or property giving rise to such income are used in or held for use in carrying on an activity giving rise to industrial or commercial profits through a permanent establishment and whether the activities carried on through such permanent establishment were a material factor in the realization of the income. For this purpose, due regard will be given to whether or not such property or rights or such income were accoun
ed for through such permanent esta
lishment.

Under paragraph (7), where indu
trial or commercial profits inclu
items of income which are dealt wi
separately in other articles of the Co
vention, the provisions of those articl
will, except as otherwise provid
therein, supersede the provisions
this Article. Thus, for example, tax
tion of interest income (other than i
terest treated as income from re
property under paragraph (1) of Ar
cle 7 (Income from Real Property
will be controlled by Article 12 (Inte
est) and not by this Article unless t
interest is effectively connected with
permanent establishment.

Article 9. SHIPPING AND AIR TRANSPORT

Paragraph (1) provides that, no
withstanding Article 8 (Business Pro
its), income derived by a resident
one Contracting State from the oper
tion in international traffic of ships
aircraft, shall be exempt from tax
the other Contracting State. Gai
from the sale, exchange, or other di
position of ships or aircraft are dea
with in the general rule of paragrap
(1) of Article 14 (Capital Gains).

Under paragraph (2), this artic
applies to income derived from t
rental of such ships or aircraft under
full or bareboat charter if the lessor
engaged in the operation of ships
aircraft in international traffic and t
rental income is incidental to such o
erations of the lessor. For example,
an airline which is a resident of o
Contracting State has excess equi
ment in the winter months and leas
several of its aircraft which are not r
quired by it during that period to
airline which is a resident of the oth
Contracting State, that rental inco
of the lessor is not subject to tax by t
other Contracting State.

Paragraph (2) also makes clear th
the article applies to income deriv
by a resident of one Contracting Sta
from the use, maintenance, and lea
of containers, trailers for the inla
transportation of containers and oth
related equipment in connection wi
the operation by the resident in int
national traffic of ships or aircraft
scribed in paragraph (1).

Paragraph (2) makes explicit that income derived from the operation in international traffic of ships or aircraft means income derived directly from the operation of ships or aircraft and does not include dividends received by a shareholder in a corporation, where such corporation operates ships or aircraft in international traffic.

This article is subject to the saving clause of paragraph (3) of Article 6 (General Rules of Taxation). Therefore, a Contracting State may tax income from international traffic derived by a resident of the other Contracting State without regard to this article if such resident is a citizen of the first-mentioned Contracting State.

Paragraph (3) provides that the limited existing exemption of U.S. air transport enterprises afforded by Decree to the Egyptian Council of Ministers of November 23, 1955 shall cease to have effect upon entry into force of this Convention.

Article 10. RELATED PERSONS

This Article complements section 482 of the Code and confirms the authority of the United States under that section. Thus, where a person subject to the taxing jurisdiction of a Contracting State (whether or not a resident thereof) and any other related person make arrangements or impose conditions between themselves which are different from those which would be made between independent persons, under paragraph (1), any income, deductions, credits or allowances which would, but for those arrangements or conditions, have been taken into account in computing the income or loss of, or the tax payable by, one of such persons, may be taken into account in computing the amount of the income subject to tax and the taxes payable by such person in the Contracting State.

Paragraph (2) sets forth an explicit formulation of the consequence of a redetermination made in accordance with paragraph (1) by a Contracting State to the income of one of its residents. In such event, the other Contracting State will, if it agrees with such redetermination and if necessary to prevent double taxation, make a corresponding adjustment to the income of a person in such other Contracting State related to such resident. If the other Contracting State disagrees with the redetermination, the two Contracting States will endeavor to reach agreement in accordance with the mutual agreement procedure in paragraph (2) of Article 27 (Mutual Agreement Procedure).

Paragraph (3) provides that for purposes of the Convention a person is related to another person if either person owns or controls directly or indirectly the other, or if a third person or persons own or control directly or indirectly both. "Control" includes any kind of control, whether or not legally enforceable, and however exercised or exercisable.

Article 11. DIVIDENDS

Paragraph (1) provides that dividends derived from sources within one Contracting State by a resident of the other Contracting State may be taxed by both Contracting States.

Paragraph (2) limits the rate of tax imposed by the United States to a rate not in excess of fifteen percent of the gross amount of the dividends paid by a United States corporation to an Egyptian resident. However, if the dividend recipient is an Egyptian corporation, the rate of tax imposed by the United States may not exceed five percent of the gross amount of the dividend paid by a United States corporation. This additional rate limitation only applies if during the part of the paying corporation's taxable year which precedes the date of payment of the dividend and during the whole of its prior taxable year (if any), at least ten percent of the outstanding voting stock of the paying corporation was owned by the recipient corporation, and not more than twenty-five percent of the gross income of the paying corporation for such prior taxable year (if any) consists of interest or dividends (other than interest derived from the conduct of a banking, insurance, or financing business and dividends or interest received from subsidiary corporations, fifty percent or more of the outstanding voting stock of which is owned by the paying corporation at the time such dividends or interest is received). These rate limitations do not affect the taxation of profits of the company which pays the dividends.

Paragraph (3) provides that dividends paid by an Egyptian corporation to a resident of the United States will be subject to the following Egyptian taxes (and substantially similar taxes enacted after August 24, 1980) to be deducted at the source: (a) the tax on income derived from movable capital; (b) the defense tax; (c) the national security tax; (d) the war tax; and (e) the supplementary taxes computed on the basis of the previously mentioned taxes (these taxes are hereinafter referred to collectively as "taxes on income from movable capital"). However, to the extent such dividends are distributed out of the current year's earnings, the amount of such dividend will be allowed as a deduction to the corporation in computing its taxable profits subject to the Egyptian taxes on industrial and commercial profits. Dividends paid to a U.S. corporation will not be subject to any other Egyptian taxes.

The rate of the taxes on income from movable capital is essentially the same as that of the taxes on industrial and commercial profits. Thus, double taxation by Egypt is avoided under internal Egyptian law to the extent earnings are distributed currently. Conversely, if current earnings are not distributed, such earnings will be subject to the taxes on industrial and commercial profits in the year earned and to the taxes on income from movable capital in the year distributed.

In the case of dividends paid to a natural person who is a resident of the United States, paragraph (3) provides that Egypt may also impose its graduated general income tax on such dividends in addition to the taxes on income from movable capital. However, in applying these graduated rates, the total general income tax on the dividend income of an individual may not exceed an average of 20 percent of the net dividends. Thus, where the Egyptian taxable income of the individual is so small that the marginal rate applicable to the dividends is less than 20 percent, the tax will fall below the maximum; and where the aggregate income is so large that the marginal rates exceed 20 percent, the higher marginal rates will apply, but only to the point where the average rate of general income tax on the income does not exceed 20 percent.

Paragraph (4) provides that the limitations of paragraphs (2) and (3) will not apply if the dividends are treated, under paragraph (6) of Article 8 (Business Profits), as industrial or commercial profits attributable to a permanent establishment which the recipient has in the source Contracting State. In such case, the provisions of Article 8 (Business Profits) will apply. If the recipient of the dividend is a citizen of the source Contracting State, that Contracting State may tax the recipient without regard to this article because of the saving clause of paragraph (3) of Article 6 (General Rules of Taxation).

Paragraph (5) provides that Egypt may tax dividends paid by a United States corporation whose activities lie solely or mainly in Egypt as though paid by an Egyptian corporation. Accordingly, dividends paid by such a corporation to United States residents will be taxed in the manner prescribed in paragraph (3) of this Article. Thus, a United States corporation whose activities lie solely or mainly in Egypt, even though its head or administrative office is outside Egypt, will be subject to the Egyptian taxes on industrial and commercial profits computed on its income after deducting the amount of current income distributed as dividends. Such dividends, in turn, will be subject to the taxes on income from movable capital which are deducted at the source; and, by virtue of paragraph (1)(a) of Article 4 (Source of Income), such dividends will be treated as income from sources within Egypt. The factors determining when a foreign company's activities lie solely or mainly in Egypt are not specified in the treaty or in Egyptian statutory law; however, the Egyptian tax authorities take into account such elements as the corporation's charter, balance sheet, and profit and loss statement, and the ratio of profits from sources in Egypt to total profits. In substance, this provision reflects those aspects of internal Egyptian tax law which, in order to avoid discrimination between Egyptian and foreign corporations, treat foreign corporations most of whose activities are conducted through an Egyptian branch as Egyptian corporations for Egyptian tax purposes.

Paragraph (6) applies to the yearly profits attributable to an Egyptian permanent establishment of a United States corporation (other than a United States corporation specified in paragraph (5)) which are deemed distributed currently as a dividend in accordance with the provisions of Egyptian taxation law. These dividends deemed paid will be deductible for purposes of computing the income subject to the taxes on industrial and commercial profits and hence they will be subject only to the Egyptian taxes specified in paragraph (3).

Paragraph (7) defines the term "dividends" to mean income from shares and similar rights, which are not debt claims and which participate in profits. The term includes income from other corporate rights which is treated as income from shares under the taxation laws of the State of residence of the corporation making the distribution. Each Contracting State may apply its domestic law rules for differentiating dividends from interest and other disbursements, subject to an agreement between the competent authorities as to a common meaning. See paragraph (2) of Article 2 (General Definitions).

Article 12. INTEREST

Paragraph (1) provides that interest derived by a resident of one Contracting State from sources within the other Contracting State may be taxed by both Contracting States. However, paragraph (2) limits the rate of tax in the Contracting State of source to a rate not in excess of 15 percent of the gross amount of the interest.

Paragraph (3) provides that interest beneficially derived by one of the Contracting States, or by an instrumentality of that Contracting State not subject to tax by that Contracting State on its income, will be exempt from tax by the other Contracting State. Under this rule, interest income derived by the Export-Import Bank of the United States and the Overseas Private Investment Corporation (OPIC) on loans made to Egyptian residents will be exempt from tax in Egypt. The exemption also applies where a resident of a Contracting State receives interest income with respect to debt obligations made, guaranteed or insured by that Contracting State or an instrumentality thereof.

Paragraph (4) provides that interest paid by a resident of one Contracting State to a person other than a resident of the other Contracting State (and in the case of interest paid by a resident of Egypt, to a person other than a United States citizen) will be exempt from tax by the other Contracting State unless such interest is treated as income from sources within the other Contracting State under paragraph (2) of Article 4 (Source of Income).

Paragraph (5) provides that the limitations of paragraphs (2), (3) and (4) will not apply if the interest is treated, under paragraph (6) of Article 8 (Business Profits), as industrial or commercial profits attributable to a permanent establishment which the recipient has in the source Contracting State. In such a case, the provisions of Article 8 (Business Profits) will apply.

If excessive interest is paid to a related person, paragraph (6) provides that the article does not apply to the excessive portion of the payment. The excessive portion may be taxed by each Contracting State according to its own laws, including the Convention, where applicable. In the case of the United States, the excessive portion may be taxed as a dividend, in which case the provisions of Article 11 (Dividends will apply.

Paragraph (7) defines interest fo purposes of the Convention as incom from money lent and other incom which under the taxation law of th Contracting State in which the incom has its source is assimilated to incom from money lent. However, the term "interest" does not include interest o indebtedness secured by mortgages o real estate or other amounts consid ered income from real property und Article 7 (Income from Real Property and to which the provisions of Artic 7 apply.

This Article is subject to the savin clause of paragraph (3) of Article (General Rules of Taxation). Ther fore, interest derived by a citizen of th source Contracting State may be taxe by that Contracting State without r gard to this Article.

Article 13. ROYALTIES

Paragraph (1) provides that royalties derived by a resident of one Contracting State from sources within the other Contracting State may be taxed by both Contracting States. However, paragraph (1) limits the tax in that other Contracting State to a rate not to exceed 15 percent of the gross amount of such royalty.

The term "royalties" is defined in paragraph (2) as payments of any kind made as consideration for the use of, or the right to use, copyrights of literary, artistic, or scientific works (but not including copyrights of motion picture films or films or tapes used for radio or television broadcasting which are industrial and commercial profits within the meaning of paragraph (5) of Article 8 (Business Profits)), and patents, designs, models, plans, secret processes or formulae, trademarks, or other like property or rights. The term "royalties" also includes gains derived from the sale, exchange, or other disposition of such property or rights to the extent the amounts realized on such sale, exchange or other disposition for consideration are contingent on the productivity, use, or disposition of the property or rights. If the amounts realized are not so contingent, the provisions of Article 14 (Capital Gains) may apply.

Paragraph (3) provides that the tax rate limitations of paragraph (1) shall not apply if the royalty is treated, under paragraph (6) of Article 8 (Business Profits), as industrial or commercial profits attributable to a permanent establishment which the recipient, a resident of one Contracting State, has in the other Contracting State. In such a case, the provisions of Article 8 will apply.

Paragraph (4) provides that this article will not apply to dividends paid on founders' shares issued in Egypt as consideration for the rights mentioned in paragraph (2) of this article and which are taxed in Egypt in accordance with the provisions of Article 1 of Law No. 14 of 1939. In such case, the provisions of Article 11 (Dividends) will apply.

If excessive royalties are paid to a related person, paragraph (5) provides that the Article does not apply to the excessive portion of the royalty. The excessive portion may be taxed by each Contracting State according to its own laws, including the Convention where applicable. Thus, in the case of the United States, the excessive portion may be treated as a dividend or interest, or in whatever other manner is appropriate.

As noted under paragraph (3) of Article 4 (Source of Income), royalties (including contingent gains) will be treated as income from sources within a Contracting State only to the extent they are payments made as consideration for the use of, or the right to use, property or rights described in paragraph (2) within that Contracting State. This source rule is similar to the source rule in section 861(a)(4) of the Code.

This article is subject to the saving clause of paragraph (3) of Article 6 (General Rules of Taxation). Therefore, royalties derived by a citizen of the source Contracting State may be taxed by that Contracting State without regard to this article.

Article 14. CAPITAL GAINS

Under paragraph (1), a resident of one Contracting State will be exempt from tax by the other Contracting State on gains from the sale, exchange, or other disposition of capital assets. However, the exemption does not apply if (1) the gain is from the sale, exchange or other disposition of property described in Article 7 (Income from Real Property) situated within the other Contracting State; (b) the gain is from the sale, exchange or other disposition of property described in paragraph (2)(b) of Article 13 (Royalties); (c) the gain is treated, under paragraph (6) of Article 8 (Business Profits), as industrial or commercial profits attributable to a permanent establishment which the recipient has in the other Contracting State; or (d) the gain is realized by an individual resident of one Contracting State who is present in the other Contracting State for a period or periods aggregating 183 days or more during the taxable year. For purposes of this Article and the other physical presence tests contained in the Convention with regard to an individual, the term "day" means a calendar day during any portion of which the individual is physically present in the relevant Contracting State.

Paragraph (2) provides that the provisions of Article 7 (Income from Real Property) will apply to real property gains; the provisions of Article 13 (Royalties) will apply to certain royalty gains; and the provisions of Article 8 (Business Profits) will apply to gains attributable to a permanent establishment.

If the recipient of the gain is a resident of one Contracting State and a citizen of the other Contracting State, that other Contracting State may tax the recipient without regard to this Article because of the saving clause of paragraph (3) of Article 6 (General Rules of Taxation).

Article 15. INDEPENDENT PERSONAL SERVICES

In dealing with the taxation of income from personal services the Convention distinguishes between "independent" and "dependent" personal services. The Convention also provides special treatment for individuals who are "public entertainers" and for amounts received for furnishing the personal services of others.

Under paragraph (1), income derived by an individual resident of one Contracting State from the performance of personal services in an independent capacity may be taxed only by that Contracting State. However, under paragraph (2), such income derived from services performed in the other Contracting State may also be subject to tax in that other Contracting State if the individual is present therein for a period or periods aggregating 90 days or more in the taxable year. Under the saving clause of paragraph (3) of Article 6 (General Rules of Taxation), the other Contracting State may also tax any individual who is a citizen of that other Contracting State without regard to this Article.

Services performed by an individual in an independent capacity are services performed for his own account where he receives the income and bears the losses arising from such services. Generally, as noted in paragraph (3), the term "personal services in an independent capacity" includes but is not limited to, scientific, literary, artistic, educational, or teaching activities as well as services rendered by physicians, lawyers, engineers, architects, dentists and accountants performing personal services.

Article 16. DEPENDENT PERSONAL SERVICES

Under paragraph (1), wages, salaries, and similar remuneration derived by an individual who is a resident of one Contracting State from labor or personal services performed as an employee, including income from services performed by an officer of a corporation or company, may be taxed by that Contracting State, except as provided in Articles 21 (Governmental Functions), 22 (Teachers), and 23 (Students and Trainees). In addition, except as provided by paragraph (2) and Articles 19 (Private Pensions and Annuities), 21 (Governmental Functions), 22 (Teachers), and 23 (Students and Trainees), such remuneration derived from sources within the other Contracting State may be taxed by that other Contracting State.

Under paragraph (2), dependent personal service income derived by an individual resident of one Contracting State will be exempt from tax by the other Contracting State if: (a) the individual is present in that other Contracting State for a period or periods aggregating less than 90 days in the taxable year; (b) the individual is an employee of a resident of the first-mentioned Contracting State or of a permanent establishment maintained in the first-mentioned Contracting State; (c) the remuneration is not borne as such (i.e., as a deduction for salary payments) by a permanent establishment which the employer has in the other Contracting State; and (d) the remuneration is subject to tax in the first-mentioned Contracting State. Income of a United States citizen or resident which is excluded from tax by reason of section 911 is not considered subject to tax by the United States. Dependent personal service income may also be taxed by that other Contracting State without regard to this article if the individual is a citizen of that other Contracting State, because of the saving clause of paragraph (3) of Article 6 (General Rules of Taxation).

Under paragraph (3), and notwithstanding paragraphs (1) and (2), remuneration derived by an employee (even if a resident of a State other than a Contracting State) of a resident of one Contracting State for labor or personal services performed as a member of the regular complement of a ship or aircraft operated in international traffic by a resident of that Contracting State may be taxed by that Contracting State.

Article 17. PUBLIC ENTERTAINERS

This Article provides that, notwithstanding Articles 15 (Independent Personal Services) and 16 (Dependent Personal Services), income derived by an individual resident of one Contracting State from his performance of personal services in the other Contracting State as a public entertainer, such as a theater, motion picture, radio or television artist, a musician, or athlete, may be taxed by the other Contracting State only if the gross amount of such income exceeds $400 or its equivalent in Egyptian pounds for each day the individual is present in the other Contracting State for the purpose of performing such services therein. If the entertainer's gross income exceeds $400 per day he may be taxed on the full amount of his income, not just the amount in excess of $400.

If the individual receives a fixed amount for performing the services on more than one day, the amount received will be prorated over the number of days the individual performs the services. Thus, for example, if an entertainer resident in Egypt receives $5,000 to perform in a series of 5 concerts in the United States on 5 different days and spend an additional 5 days in the United States in rehearsal for those concerts over a two week period, he will be considered to have received $500 for each day and thus, pursuant to this Article, he may be taxed by the United States.

Income derived from services rendered by producers, directors, technicians, and others who are not public entertainers is taxable in accordance with the provisions of Article 15 (Independent Personal Services), or Article 16 (Dependent Personal Services), as the case may be.

Under the saving clause of paragraph (3) of Article 6 (General Rules of Taxation), if the individual is a citizen of a Contracting State that State may tax his income without regard to this Article.

Article 18. AMOUNTS RECEIVED FOR FURNISHING PERSONAL SERVICES OF OTHERS

Paragraph (1) provides that, notwithstanding the provisions of Article 8 (Business Profits), amounts received by a resident of one Contracting State in consideration of furnishing in the other Contracting State the personal services of one or more other persons, including a public entertainer referred to in Article 17 (Public Entertainers), may be subject to tax under the taxation laws of each Contracting State to the extent that: the person for whom the services were furnished designated the person or persons who would render the services, whether or not he had the legal right to do so and whether or not the designation was made formally; the person for whom the services were furnished had the right to designate the person or persons who would render the services; or, by reason of the facts and circumstances, the arrangement for personal services had the effect of designating the person or persons who would render the services; and the resident of the first-mentioned Contracting State directly or indirectly pays compensation for such services to any person, other than another resident of the first-mentioned Contracting State or of that other Contracting State who is subject to tax on such compensation. If this paragraph applies, the amounts received for providing personal services of other individuals in the other Contracting State may be taxed by that other Contracting State even though not attributable to a permanent establishment.

Paragraph (2) provides that paragraph (1) will not apply if it is established to the satisfaction of the competent authority of that other Contracting State with respect to any amoun received that neither the creation no organization of the resident of th first-mentioned Contracting State (where such resident is a corporation or other entity) nor the furnishing of the services through such resident has the effect of a substantial reduction in income, war profits, excess profits, or similar taxes. The taxes referred to in the preceding sentence are those enumerated in Article 1 (Taxes Covered) which are imposed by the two Contracting States.

Article 19. PRIVATE PENSIONS AND ANNUITIES

Except as provided in Article 21 (Governmental Functions), pensions and other similar remuneration paid to an individual will be taxable under paragraph (1) only in the Contracting State of which he is a resident. Thus, private pensions and similar remuneration derived from sources within one Contracting State by an individual resident of the other Contracting State are exempt from tax in the first-mentioned Contracting State. Pensions for Government service are dealt with in Article 21 (Governmental Functions). The term "pensions and other similar remuneration" is defined in paragraph (4) as periodic payments, other than social security payments covered in Article 20 (Social Security Payments), made by reason of retirement or death and in consideration for services rendered, or by way of compensation for injuries or sickness received in connection with past employment.

Paragraph (2) provides that alimony and annuities paid to an individual resident of a Contracting State will be taxable only in that Contracting State. The term "annuities" is defined in paragraph (5) as a stated sum paid periodically at stated times during life, or during a specified number of years, under an obligation to make the payments in return for adequate and full consideration (other than for services rendered). The term "alimony" is defined in paragraph (6) as periodic payments made pursuant to a written separation agreement or a decree of divorce, separate maintenance, or compulsory support which are taxable to the recipient under the internal laws of the Contracting State of which he is a resident. Thus, the term "alimony" would not include a payment which would not be taxable to the recipient under the laws of the Contracting State in which he is resident even though such payment is made pursuant to a decree of divorce or of separate maintenance.

Paragraph (3) provides that child support payments made by an individual resident of one Contracting State to an individual resident of the other Contracting State will be exempt from tax in that other Contracting State. The term "child support payments" is defined in paragraph (7) as periodic payments for the support of a minor child made pursuant to a written separation agreement or a decree of divorce, separate maintenance, or compulsory support.

Except for paragraph (3), dealing with child support, this article is subject to the saving clause of paragraph (3) of Article 6 (General Rules of Taxation). Therefore, individuals who are citizens or residents of a Contracting State may be taxed by that Contracting State without regard to this article.

Article 20. SOCIAL SECURITY PAYMENTS

This article provides that social security payments and other public pensions, e.g., railroad retirement benefits, paid by one Contracting State to an individual who is a resident of the other Contracting State shall be taxable only in that other Contracting State. Payments described in Article 21 (Governmental Functions) are not covered by this article.

Under paragraph (2) of Article 32 (Termination), this article may be terminated by either Contracting State at any time after the Convention enters into force.

Under paragraph (4)(a) of Article 6 (General Rules of Taxation), the saving clause of paragraph (3) of Article 6 does not apply to the provisions of this Article. Thus, the exemption applies even to a citizen of a Contracting State.

Article 21. GOVERNMENTAL FUNCTIONS

Under paragraph (1) of this Article, wages, salaries, or similar remuneration, including pensions, annuities, or similar benefits, paid from public funds of one Contracting State to a citizen of that Contracting State, or to a citizen of a State other than a Contracting State who comes to the other Contracting State expressly for the purpose of being employed by the first-mentioned Contracting State, for labor or personal services performed as an employee of the national Government of that Contracting State, or any agency thereof, in the discharge of functions of a governmental nature will be exempt from tax by the other Contracting State. If the individual becomes a citizen of, or acquires immigrant status in, the other Contracting State, that other Contracting State may tax the individual without regard to this article. See paragraphs (3) and (4)(b) of Article 6 (General Rules of Taxation).

Whether services will be treated as performed in the discharge of governmental functions may be determined by reference to the concept of a governmental function in the State in which the income arises. Thus, as provided in paragraph (2), remuneration or pensions paid in respect of services rendered in connection with any trade or business carried on by one of the Contracting States or any agency thereof will be treated the same as compensation received from a private employer, and the provisions of Articles 16 (Dependent Personal Services) and 19 (Private Pensions and Annuities) will apply.

This Article applies only to remuneration paid by the national Government or agencies of the national Government of a Contracting State.

Article 22. TEACHERS

Paragraph (1) provides that, if a resident of one Contracting State is invited by the other Contracting State, a political subdivision or local authority thereof, or by a university or other recognized educational institution in that other Contracting State to come to that other Contracting State for a period not expected to exceed two years for the purpose of teaching or engaging in research, or both, at a university or other recognized educational institution, and if such resident comes to that other Contracting State primarily for such purpose, his income from personal services for teaching or research at such university or educational institution will be exempt from tax by that other Contracting State for a period not exceeding two years from the date of his arrival in that other Contracting State.

Since a temporary visit may be of such a duration that an individual may lose his status as a resident of the Contracting State of which he was a resident at the time he became eligible for the benefits of this article, the individual need only be a resident of such Contracting State at the beginning of his visit. However, if the individual becomes a citizen of, or acquires immigrant status in, the other Contracting State, that other Contracting State may tax the individual without regard to this article. See paragraphs (3) and (4)(b) of Article 6 (General Rules of Taxation). If the individual's visit exceeds a period of two years from the date of his arrival, the exemption applies only to the income received by the individual before the expiration of such two year period.

Pursuant to paragraph (2), this article does not apply to income from research undertaken not in the public interest but primarily for the private benefit of a specific person or persons other than the person performing the research.

Article 23. STUDENTS AND TRAINEES

Paragraph (1) provides that an individual who is a resident of one Contracting State at the time he becomes temporarily present in the other Contracting State and who is temporarily present therein for the primary purpose of studying at a university or other recognized educational institution, securing training required to qualify him to practice a profession or professional specialty, or studying or doing research as a recipient of a grant, allowance, or award from a governmental, religious, charitable, scientific, literary, or educational organization, will be exempt from tax by that other Contracting State for a period not exceeding five taxable years from the date of his arrival in that other Contracting State and for such additional period of time as is necessary to complete, as a full-time student, the educational requirements as a candidate for a postgraduate or professional degree from a recognized educational institution on:

(1) gifts from abroad for the purpose of his maintenance, education, study, research, or training;
(2) the grant, allowance, or award; and
(3) income from personal services performed in the other Contracting State not in excess of $3,000 or its equivalent in Egyptian pounds for any taxable year.

Under paragraph (2), an individual who is a resident of one Contracting State at the time he becomes temporarily present in the other Contracting State and who is temporarily present therein as an employee of, or under contract with, a resident of the first-mentioned Contracting State, for the primary purpose of acquiring technical, professional, or business experience from a person other than that resident of the first-mentioned Contracting State or other than a person related to such resident, or studying at a university or other recognized educational institution in that other Contracting State, will be exempt from tax by that other Contracting State for a period not exceeding twelve consecutive months, on income from personal services not in excess of $7,500 or its equivalent in Egyptian pounds.

Under paragraph (3), an individual who is a resident of one Contracting State at the time he becomes temporarily present in the other Contracting State and who is temporarily present therein for a period not exceeding one year, as a participant in a program sponsored by the other Contracting State, for the primary purpose of training, research, or study, will be exempt from tax by the other Contracting State with respect to his income from personal services in respect of such training, research, or study performed in that other Contracting State in an aggregate amount not in excess of $10,000 or its equivalent in Egyptian pounds.

The monetary limits provided in paragraphs (1), (2), or (3) are in addition to, and not in lieu of, other exemptions provided by the Code. Thus, an unmarried resident of Egypt who is temporarily present in the United States for the primary purpose of studying at a university would be entitled to exclude $3,000 of income from the performance of personal services and, in addition, would be entitled to the personal exemption allowed by section 151 of the Code, as provided in section 873(b) of the Code.

The first sentence of paragraph (4) provides that the benefits provided in paragraph (1) and the benefits provided under Article 22 (Teachers), when taken together, may extend only for such period of time, not to exceed five taxable years from the date of the individual's arrival, as may reasonably or customarily be required to effectuate the purpose of the visit, and for such additional period of time as is specified in paragraph (1). The second sentence of paragraph (4) makes it clear that the benefits provided by Article 22 will not be available to an individual if, during the immediately preceding period, the individual enjoyed the benefits provided by paragraph (1). Thus, an Egyptian individual who originally entered the United States for the purpose of becoming a student and received benefits under paragraph (1) must leave the United States and, if necessary, reestablish residence in Egypt, and then return at the invitation of the United States, a political subdivision or local authority thereof, or a university or other recognized educational institution for the primary purpose of becoming a teacher in order to take advantage of Article 22.

If an individual qualifies for the benefits of more than one of the provisions of Article 22 (Teachers) and this Article, such individual may choose the most favorable provision, but may not claim the benefits of more than one provision in any taxable year as a means of avoiding the limitations provided. Thus, for example, an individual who comes to the other Contracting State for the primary purpose of studying may be able to qualify under either paragraphs (2) or (3) of this Article. However, he cannot combine the maximum exclusion limits in those two paragraphs to exclude

$17,500 during the taxable year. If the individual becomes a citizen of, or acquires immigrant status in, the other Contracting State, that other Contracting State may tax the individual without regard to this Article. See paragraphs (3) and (4)(b) of Article 6 (General Rules of Taxation).

Article 24. INVESTMENT OR HOLDING COMPANIES

The article provides that a corporation of one Contracting State deriving dividends, interest, royalties or capital gains from sources within the other Contracting State will not be entitled to the benefits of Articles 11 (Dividends), 12 (Interest), 13 (Royalties) or 14 (Capital Gains) if, by reason of special measures, the tax imposed on such corporation by the first-mentioned Contracting State with respect to such dividends, interest, royalties or capital gains is substantially less than the tax generally imposed by such Contracting State on corporate profits, and twenty-five percent or more of the capital of such corporation is held of record or is otherwise determined, after consultation between the competent authorities of the Contracting States, to be owned, directly or indirectly, by one or more persons who are not individual residents of the first-mentioned Contracting State (or, in the case of an Egyptian corporation, who are citizens of the United States). For purposes of applying this Article, it is intended that the requisite direct or indirect ownership be tested at the individual shareholder level. Existing Code provisions dealing with the taxation of capital gains do not make this article applicable with respect to capital gains.

The purpose of this Article is to deal with potential abuse which could occur if one of the Contracting States provided preferential rates of tax for investment or holding companies. In the absence of this Article, residents of third countries could organize a corporation in the Contracting State extending the preferential rates for the purpose of making investments in the other Contracting State. The combination of low tax rates in the first-mentioned Contracting State and the reduced rates or exemptions in the other Contracting State would enable the third country residents to realize unintended benefits.

Article 25. RELIEF FROM DOUBLE TAXATION

In order to avoid double taxation, each Contracting State agrees in this Article to provide to its citizens or residents a credit against its taxes for taxes paid by such persons to the other Contracting State.

In paragraph (1), the United States agrees to allow a United States citizen or resident as a credit against United States tax an appropriate amount of taxes paid or accrued to Egypt in accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle of paragraph (1)). In addition, in the case of a United States corporation owning at least ten percent of the voting stock of an Egyptian corporation from which it receives dividends in any taxable year, the United States will allow a credit for the appropriate amount of taxes paid or accrued to Egypt by the Egyptian corporation paying such dividends with respect to the profits out of which such dividends are paid. The appropriate amount will be based upon the amount of tax paid or accrued to Egypt, but the credit is not to exceed the limitations (for the purpose of limiting the credit to the United States tax on income from sources within Egypt or on income from sources outside the United States) provided by United States law for the taxable year. This provision does not require the United States to maintain a per-country or overall limitation in the future so long as the general principle of a foreign tax credit remains in effect. For the purpose of applying the United States credit in relation to taxes paid or accrued to Egypt, the rules set forth in Article 4 (Source of Income) will be applied to determine the source of income, and the taxes referred to in paragraphs (1)(b) and (2) of Article 1 (Taxes Covered) will be considered to be income taxes. Whether Egyptian taxes are paid or accrued is determined under the rules of the Code. A taxpayer may, for any year, claim a foreign tax credit under the rules of the Code. In that case, he would forego the rules of the Convention that guarantee income tax status for the specified Egyptian taxes.

Under paragraph (2), Egypt will allow a resident of Egypt as a credit against Egyptian tax the appropriate amount of income taxes paid or accrued to the United States and, in the case of an Egyptian corporation owning at least ten percent of the voting stock of a United States corporation from which it receives dividends in any taxable year, will also allow credit for the appropriate amount of taxes paid or accrued to the United States by the United States corporation paying such dividends with respect to the profits out of which such dividends are paid. The appropriate amount will be based upon the amount of tax paid or accrued to the United States but will not exceed that portion of Egyptian tax which such resident's net income from sources within the United States bears to his entire net income for the same taxable year. For the purpose of applying the Egyptian credit in relation to taxes paid or accrued to the United States, the rules set forth in Article 4 (Source of Income) will be applied to determine the source of income.

Paragraph (4) of Article 6 (General Rules of Taxation) provides that the saving clause in paragraph (3) of that Article does not affect the benefits conferred under this Article. Thus, the provisions of this Article may be relied upon by a citizen or resident of a Contracting State.

Article 26. NONDISCRIMINATION

Paragraph (1) provides that a citizen of one Contracting State who is a resident of the other Contracting State will not be subject in that other Contracting State to more burdensome taxes than a citizen of that other Contracting State who is a resident thereof. The determination of whether there is more burdensome taxation is to be made by comparing the treatment of individuals who are in comparable positions. Thus, for example, a citizen of Egypt who is a resident of the United States and who otherwise meets the requirements specified in section 911 of the Code would, under this Article, be eligible for the benefits of section 911 even though not a citizen of the United States.

Paragraph (2) provides that a permanent establishment which a resident of one Contracting State has in the other Contracting State will not be subject in that other Contracting State to more burdensome taxes than a resident of that other Contracting State carrying on the same activities. However, as noted in paragraph (2)(a), this does not obligate a Contracting State to grant to individual residents of the other Contracting State any personal allowances, reliefs, or deductions for taxation purposes on account of civil status or family responsibilities which it grants its own individual residents.

Under paragraph (2)(b) Egypt is not obliged to grant United States corporations the exemptions granted Egyptian corporations under Articles 5 and 6 of Law No. 14 of 1939. Article 5 of that law exempts from Egyptian tax certain foreign source investment income which an Egyptian insurance company earns on reserves which are required under foreign law to be deposited in a foreign country. Article 6 of that law exempts certain distributions to shareholders of Egyptian investment companies, where the investment company has paid tax on its dividend and interest income.

Paragraph (2)(c) preserves the rules of the first and second paragraphs of Article 11 and Article 11 bis of Law No. 14 of 1939. Under these provisions of Egyptian law, the Egyptian branch profits of a foreign corporation are deemed to be distributed and are treated as dividends. Thus, a branch of a foreign corporation is subject to tax on deemed distribution, while an Egyptian corporation is not, because the actual tax on the Egyptian corporation's dividends falls on the recipient and not on the paying corporation. Paragraphs (5) and (6) of Article 11 (Dividends) provide for this treatment. Paragraph (2)(c) of this Article confirms that this treatment will not be considered discriminatory.

Paragraph (3) prohibits one Contracting State from subjecting a corporation of such Contracting State, the capital of which is wholly or partly owned, directly or indirectly, by one or more residents of the other Contracting State to any taxation or any requirement connected with taxation which is other or more burdensome than those applicable to corporations of the first-mentioned Contracting State carrying on the same activities, the capital of which is wholly or partly owned or controlled by one or more residents of the first-mentioned Contracting State.

The provisions of this Article do not override the right of the United States to impose the tax provided in Code section 897 (relating to gains derived by nonresident aliens or foreign corporations from U.S. real property interests).

Under paragraph (3) of Article 1 (Taxes Covered), the provisions of this Article extend to all taxes of every kind imposed at the national, state or local level.

The saving clause in paragraph (3) of Article 6 (General Rules of Taxation) does not apply to this Article. Thus, a Contracting State may not deny any rights conferred by this Article to its citizens and residents.

Article 27. MUTUAL AGREEMENT PROCEDURE

Under paragraph (1), when a resident or citizen of one Contracting State considers that action of one or both Contracting States results or will result for him in taxation not in accordance with the Convention, he may, notwithstanding the remedies provided by the national laws of the Contracting States, present his case to the competent authority of the Contracting State of which he is a resident or citizen. A resident or citizen of a Contracting State need not, although it is anticipated that in the normal situation he will, exhaust his other administrative or judicial remedies prior to resorting to the use of the mutual agreement procedure. If the claim is considered to have merit by the competent authority, that competent authority will endeavor to come to an agreement with the competent authority of the other Contracting State with a view to the avoidance of taxation not in accordance with the Convention.

Paragraph (2) requires the competent authorities of the two Contracting States to endeavor to resolve by mutual agreement any difficulties or doubts arising as to the application of the Convention. In particular, the competent authorities may agree to the same attribution of industrial or commercial profits to a resident of one Contracting State and its permanent establishment situated in the other Contracting State; the same allocation of income, deductions, credits, or allowances between a resident of one Contracting State and a related person and to the readjustment of taxes imposed by each Contracting State to reflect such allocation; the same determination of the source of particular items of income; and the same characterization of particular items of income; The list of subjects of potential mutual agreement in paragraph (2) is not exhaustive; it merely illustrates the principles set forth in the paragraph.

Under paragraph (3), in implementing the provisions of this article, the competent authorities may communicate with each other directly and, when advisable, meet together for an oral exchange of opinions.

Under paragraph (4), in cases in which the competent authorities reach an agreement, taxes will be imposed on such income, and refund or credit of taxes allowed, by the Contracting States in accordance with such agreement. This permits the issuance of a refund or credit notwithstanding procedural barriers otherwise existing under a Contracting State's law, such as the statute of limitations. However, it does not authorize imposition of additional taxes after the statute of limitations has run.

Article 28. EXCHANGE OF INFORMATION

Paragraph (1) provides for a system of administrative cooperation between the competent authorities of the two Contracting States by requiring an exchange of information necessary for the carrying out of the Convention and of the domestic laws of the Contracting States concerning taxes covered by the Convention insofar as the taxation thereunder is in accordance with the Convention. Under paragraph (3) of Article 1 (Taxes Covered), the provisions of this article extend to all taxes of every kind imposed at the national level. The competent authorities may exchange information in connection with tax compliance generally, not merely illegal acts or crimes. Information need be exchanged, however, only if it is of a class that can be obtained under the laws and administrative practices of each Contracting State with respect to its own taxes.

Paragraph (2) provides that information exchanged must be treated as secret. However, such information may be disclosed to any persons or authorities concerned with or made part of the public record with respect to the assessment, collection, or enforcement of, or litigation with respect to, the taxes which are the subject of the Convention. Thus, disclosure is not prohibited as a part of a public proceeding before a court or an administrative body.

Paragraph (3) provides that no information may be exchanged which would be contrary to the public policy.

Paragraph (4) provides that depositions of witnesses and copies of unedited original documents (including books, papers, statements, records, accounts, or writings) shall be provided by the competent authority of a Contracting State, if specifically requested by the competent authority of the other Contracting State, to the extent such depositions and documents can be obtained under the laws and administrative practices of each Contracting State with respect to its own taxes.

Paragraph (5) provides that any depositions and evidence which may be furnished in accordance with this article should not be withheld by reason of any doctrine of law under which international judicial assistance is not accorded in tax matters.

Paragraph (6) provides that the exchange of information may be on either a routine basis or on request with reference to particular cases, and that the competent authorities may agree on the list of information to be furnished on a routine basis.

In making the determinations necessary under paragraphs (1) and (4) of this Article, a Contracting State will use the standards it uses in the enforcement of its own laws by its administrative and judicial authorities, treating the tax of the Contracting State with respect to which a request relates as if it were a tax of the Contracting State requested to furnish the information and were being imposed by such Contracting State.

Article 29. ASSISTANCE IN COLLECTION

Paragraph (1) provides that one Contracting State will give the other Contracting State limited assistance in collecting its taxes. Thus, each Contracting State is required to collect on behalf of the other Contracting State only those taxes imposed by such other Contracting State as will ensure that any exemption or reduced rate of tax granted under this Convention by such other Contracting State is not enjoyed by persons not entitled to such benefits.

Paragraph (2) makes clear that a Contracting State is not obligated to carry out measures at variance with the laws or the administrative practice of either Contracting State with respect to the collection of its own taxes.

Article 30. DIPLOMATIC AND CONSULAR OFFICERS

This Article provides that nothing in the Convention will affect the fiscal privileges of diplomatic and consular officials under the general rules of international law or under the provisions of special agreements.

Article 31. ENTRY INTO FORCE

This Article provides that the Convention is subject to ratification and provides for the exchange of instruments of ratification. The Convention will enter into force thirty days after the date of exchange of such instruments of ratification. The Convention shall first have effect as respects the rate of withholding tax, to amounts paid on or after the first day of the second month following the date on which the Convention enters into force, and, as respects other taxes, to taxable years beginning on or after January 1 of the year following the date on which the Convention enters into force.

Article 32. TERMINATION

Paragraph (1) provides that the Convention will continue in force indefinitely, but that it may be terminated by either Contracting State at any time after five years from the date it enters into force. A Contracting State seeking to terminate the Convention must give at least six months' notice through diplomatic channels. If the Convention is terminated, such termination will be effective with respect to income of calendar years or taxable years beginning (or, in the cases of taxes payable at source, payments made) on or after January 1 next following the expiration of the six month period. It is intended that the reference to calendar years applies only to cases where the taxable year is the calendar year.

Under paragraph (2), the provisions of Article 20 (Social Security Payments) may be terminated by either Contracting State at any time after the Convention enters into force by prior notice given through diplomatic channels.

UNITED STATES-JAMAICA INCOME TAX CONVENTION [1]

Convention signed at Kingston
May 21, 1980;
Exchange of notes signed at
Kingston May 21, 1980;
Amending Protocol signed at
Kingston July 17, 1981;
Ratification of the Convention,
exchange of notes and the
Amending Protocol advised by
the Senate of the United
States of America December
16, 1981;
Convention, exchange of notes,
and Amending Protocol
ratified by the President of the
United States of America
December 22, 1981;
Convention, exchange of notes,
and Amending Protocol
ratified by Jamaica ;
Ratifications exchanged at
Kingston on December 29,
1981;
Proclaimed by the President of
the United States of America
January 20, 1982;

---

[1] The text of the convention is contained in the pamphlet of the Treaties and Other International Acts Series (TIAS) and is designated TIAS 10207. Pertinent excerpts from Senate Report No. 97-40, page 274; Treasury Department Technical Explanation page 291; Senate Executive 0 is not published.

Entered into force December 29, 1981

BY THE PRESIDENT OF THE UNITED STATES OF AMERICA

A PROCLAMATION

CONSIDERING THAT:

The Convention between the Government of the United States of America and the Government of Jamaica for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income was signed at Kingston on May 21, 1980, together with a related exchange of notes, and the Protocol Amending the 1980 Convention, together with a related exchange of notes, was signed at Kingston on July 17, 1981, the texts of which are hereto annexed;

The Senate of the United States of America by its resolution of December 16, 1981, two-thirds of the Senators present concurring therein, gave its advice and consent to ratification of the Convention, Amending Protocol and related exchanges of notes, subject to the following:

1) reservation that, notwithstanding the provisions of paragraph (5) of Article 13 of the Convention (which relates to the taxation of gains from the alienation of shares of a corporation or of an interest in a partnership, estate, or trust, the property of which consists, directly or indirectly, principally of real property situated in one of the countries), gain derived by a resident of a Contracting State from the alienation or other disposition of an interest in a corporation, or an interest in a partnership, trust, or estate, which has an interest in real property located in the other Contracting State, or the assets of which are considered under the domestic law of that other Contracting State to consist, in whole or in part, of real property, or an interest therein, in that other State, may be taxed by that other State to the extent provided for by its domestic law. In addition, gain derived by a corporation which is a resident of a Contracting State upon the distribution (including a distribution in liquidation or otherwise) of an interest in real property in the other Contracting State (as determined under the domestic law of the other Contracting State) may be taxed by that other Contracting State to the extent provided for by its domestic law.

2) understanding that appropriate Congressional Committees and the General Accounting Office shall be afforded access to the information exchanged under this Convention where such access is necessary to carry out their oversight responsibilities, subject only to the limitations and procedures of the Internal Revenue Code.

The Convention, Amending Protocol and related exchanges of notes were ratified, subject to the aforesaid reservation and understanding by the President of the United States of America on December 22, 1981, in pursuance of the advice and consent of the Senate, and was ratified on the part of the Government of Jamaica;

The instruments of ratification of the Convention, Amending Protocol and related exchanges of notes were exchanged at Kingston on December 29, 1981, and accordingly the Convention and Amending Protocol entered into force on December 29, 1981, effective as specified in Article 29 of the Convention;

NOW, THEREFORE, I, Ronald Reagan, President of the United States of America, proclaim and make public the Convention, Amending Protocol and related exchanges of notes to the end that they be observed and fulfilled with good faith on and after December 29, 1981, by the United States of America and by the citizens of the United States of America and all other persons subject to the jurisdiction thereof.

IN TESTIMONY WHEREOF, I have signed this proclamation and caused the Seal of the United States of America to be affixed.

DONE at the city of Washington this twentieth day of January in the year of our Lord one thousand nine hundred eighty-two and of the Independence of the United States of America the two hundred sixth.

By the President:
RONALD REAGAN

ALEXANDER M. HAIG, JR.
Secretary of State

CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF JAMAICA FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME

The Government of the United States of America and the Government of Jamaica, desiring to conclude a convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, have agreed as follows:

ARTICLE 1

PERSONAL SCOPE

1. Except as otherwise provided in this Convention, this Convention shall apply to persons who are residents of one or both of the Contracting States.

2. This Convention shall not restrict in any manner any exclusion, exemption, deduction, credit, or other allowance now or hereafter accorded—

(a) by the laws of either Contracting State; or

(b) by any other agreement between the Contracting States.

3. Notwithstanding any provision of this Convention except paragraph 4 of this Article, a Contracting State may tax its residents (as determined under Article 4 (Residence)), and by reason of citizenship may tax its citizens, as if this Convention had not come into effect.

4. The provisions of paragraph 3 shall not affect:

(a) the benefits conferred by a Contracting State under paragraphs 1 b) and 4 of Article 19 (Pensions, etc.), Article 24 (Relief from Double Taxation), Article 25 (Non-Discrimination) and Article 26 (Mutual Agreement Procedure); and

(b) the benefits conferred by a Contracting State under Articles 20 (Government Service), 21 (Students and Trainees), 22 (Teachers and Researchers) and 28 (Diplomatic Agents and Consular Officers) upon individuals who are neither citizens of, nor have immigrant status in, that State.

ARTICLE 2

TAXES COVERED

1. This Convention shall apply to taxes on income imposed by a Contracting State.

2. The existing taxes to which this Convention shall apply are:

(a) in the United States: the Federal income taxes imposed by the Internal Revenue Code, but excluding the accumulated earnings tax (except as provided in paragraph 5 of Article 10 (Dividends)) and the personal holding company tax.

(b) in Jamaica: the income tax, the company profits tax, and the transfer tax.

3. The Convention shall apply also to any identical or substantially similar taxes which are imposed by a Contracting State after the date of signature of this Convention in addition to, or in place of, the existing taxes. In addition, the Convention shall apply also to a tax imposed by Jamaica in lieu of the income tax or the company profits tax covered by paragraph 2(b). The competent authorities of the Contracting States shall notify each other of any changes which have been made in their respective taxation laws and shall notify each other of any official published material concerning the application of this Convention, including explanations, regulations, rulings, or judicial decisions.

4. For the purpose of Article 25 (Non-Discrimination), this Convention shall also apply to taxes of every kind and description imposed by a Contracting State or a political sub-division or local authority thereof. For the purpose of Article 27 (Exchange of Information and Administrative Assistance), this Convention shall also apply to taxes of every kind imposed by a Contracting State.

ARTICLE 3

GENERAL DEFINITIONS

1. For the purpose of this Convention, unless the context otherwise requires:

(a) the term "person" includes an individual, a partnership, a company, an estate, a trust, and any other body of persons;

(b) the term "company" means any body corporate or any entity which is treated as a body corporate for tax purposes;

(c) the terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean respectively an enterprise or undertaking carried on by a resident of a Contracting State and an enterprise or undertaking carried on by a resident of the other Contracting State;

(d) the term "international traffic" means any transport by a ship or aircraft except when the ship or aircraft is operated solely between places in the other Contracting State;

(e) the term "competent authority" means:

(i) in the United States: the Secretary of the Treasury, or his delegate; and

(ii) in Jamaica: the Minister responsible for finance or his authorized representative;

(f) the term "United States" means the United States of America and when used in a geographical sense includes the States thereof and the District of Columbia, the territorial waters of the United States, and any area outside the States and the District of Columbia which in accordance with international law and the laws of the United States in an area within which the rights of the United States with respect to the natural resources of the seabed and subsoil may be exercised;

(g) the term "Jamaica" means the island of Jamaica, the Morant Cays, the Pedro Cays and their Dependencies and when used in a geographical sense includes the territorial waters of Jamaica and any area outside such territorial waters which in accordance with international law and the laws of Jamaica is an area within which the rights of Jamaica with respect to the natural resources of the seabed and subsoil may be exercised;

(h) the term "Contracting State" means the United States or Jamaica, as the context requires;

(i) the term "national" means:

(i) in relation to the United States—

(*a*) any individual who is a citizen of the United States;

(*b*) any company, association or other entity deriving its status as such from the laws of the United States or any political subdivision thereof;

(ii) in relation to Jamaica—

(*a*) any individual who is a citizen of Jamaica;

(*b*) any company, association or other entity deriving its status as such from the laws of Jamaica.

2. As regards the application of this Convention by a Contracting State any term not otherwise defined shall, unless the context otherwise requires and subject to the provisions of Article 26 (Mutual Agreement Procedure), having the meaning which it has under the laws of that State relating to the taxes which are the subject of this Convention.

ARTICLE 4

RESIDENCE

1. For the purposes of this Convention:

(a) the term "resident of Jamaica" means:

(i) any person, other than a company, resident in Jamaica for the purposes of Jamaican tax; but in the case of a partnership, estate, or trust, only to the extent that the income derived by such partnership, estate, or trust is subject to Jamaican tax as the income of a resident either in its hands or in the hands of its partners or beneficiaries; and

(ii) a company whose business is managed and controlled in Jamaica.

(b) the term "resident of the United States" means:

(i) any person, other than a company, resident in the United States for the purposes of United States tax; but in the case of a partnership, estate, or trust, only to the extent that the income derived by such partnership, estate, or trust is subject to United States tax as the income of a resident, either in its hands or in the hands of its partners or beneficiaries; and

(ii) a company created or organized under the laws of the United States or a political subdivision thereof.

2. Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, the individual's status shall be determined as follows:

(a) the individual shall be deemed to be a resident of the State in which he has a permanent home available; if such individual has a permanent home available in both States, or in neither State, he shall be deemed to be a resident of the State with which his personal and economic relations are closer (center of vital interests);

(b) if the State in which the individual's center of vital interests cannot be determined, he shall be deemed to be a resident of the State in which he has an habitual abode;

(c) if the individual has an habitual abode in both States or in neither of them, he shall be deemed to be a resident of the State of which he is a national;

(d) if the individual is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

3. Where by reason of the provisions of paragraph 1 a company is a resident of both Contracting States, such company shall be considered to be outside the scope of this Convention except for purposes of paragraph 2 of Article 10 (Dividends), Article 25 (Non-Discrimination), Article 26 (Mutual Agreement Procedure), Article 27 (Exchange of Information and Administrative Assistance) and Article 29 (Entry Into Force).

4. Where by reason of the provisions of paragraph 1 a person other than an individual or a company is a resident of both Contracting States, the competent authorities of the Contracting States shall by mutual agreement endeavour to settle the question and to determine the mode of application of the Convention to such person.

5. Where under any provision of this Convention income arising in one of the Contracting States is relieved in whole or in part from tax in that Contracting State and, under the law in force in the other Contracting State a person, in respect of the said income, is subject to tax by reference to the amount thereof which is remitted to or received in that other Contracting State and not by reference to the full amount thereof, then the relief to be allowed under this Convention in the first-mentioned Contracting State shall apply only to so much of the income as is remitted to or received in the other Contracting State during the calendar year such income accrues or the next succeeding calendar year.

ARTICLE 5

PERMANENT ESTABLISHMENT

1. For the purposes of this Convention, except as otherwise specified in this Article, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term "permanent establishment" shall include especially:

(a) a place of management;

(b) a branch;

(c) an office;

(d) a factory;

(e) a workshop;

(f) a store or premises used as a sales outlet;

(g) a warehouse, in relation to a person providing storage facilities for others;

(h) a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources;

(i) a building site or construction, assembly, installation, or dredging project, or a drilling rig or ship used for the exploration or development of natural resources within a Contracting State, but only if such site, project or activity continues within that State for a period or periods aggregating more than 183 days in any twelve-month period (including the period of any supervisory activity connected therewith), provided that a permanent establishment shall not exist in any taxable year in which site, project or activity continues within that State for a period or periods aggregating less than 30 days in that taxable year;

(j) the furnishing of services, including consultancy, management and technical, and supervisory services, within a Contracting State by an enterprise through employees or other personnel, but only if (i) activities of that nature continue within that State for a period or periods aggregating more than 90 days in any twelve-month period, provided that a permanent establishment shall not exist in any taxable year in which such services are rendered in that State for a period or periods aggregating less than 30 days in that taxable year; or (ii) the services are performed within the State for a related enterprise (within the meaning of paragraph 3 of Article 9 (Associated Enterprises));

(k) the maintenance of substantial equipment or machinery within a Contracting State but only if such equipment or machinery is maintained within that State for a period of more than 120 consecutive days, provided that a permanent establishment shall not exist in any taxable year in which such equipment or machinery is maintained within that State for a period or periods aggregating less than 30 days in that taxable year.

3. Notwithstanding the preceding provisions of this Article, the term "permanent establishment' shall be deemed not to include any one or more of the following:

(a) the use of facilities solely for the purpose of storage, display, or delivery of goods or merchandise belonging to the enterprise other than goods or merchandise held for sale by such enterprise in a store or premises used as a sales outlet;

(b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery, other than goods or merchandise held for sale by such enterprise in a store or premises used as a sales outlet;

(c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

(d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise;

(e) the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research or for similar activities which have a preparatory or auxiliary character, for the enterprise.

4. If an enterprise of a Contracting State does not have a permanent establishment in the other Contracting State under paragraphs 1, 2, and 3, but goods or merchandise are either:

(a) subjected to processing in that other Contracting State by another person (whether or not purchased in that other Contracting State); or

(b) purchased in that other Contracting State (and such goods or merchandise are not subjected to processing outside that other Contracting State) then such enterprise shall be considered to have a permanent establishment in that other Contracting State to the extent that all or part of such goods or merchandise is sold by or on behalf of such enterprise for use, consumption, or disposition in that other Contracting State.

5. Notwithstanding the provisions of paragraphs 1 and 2, a person (other than an agent of an independent status to whom paragraph 6 applies) acting in a Contracting State on behalf of an enterprise of the other Contracting State shall be deemed to be a permanent establishment of that enterprise in the first-mentioned State if:

(a) he has and habitually exercises in the first-mentioned State an authority to conclude contracts on behalf of the enterprise, unless his activities are limited to those mentioned in paragraph 3 which, if exercised through a fixed place of business, would not make that fixed place of business a permanent establishment under the provisions of that paragraph (subject to the provisions of paragraph 4); or

(b) he habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise and additional activities conducted in that State on behalf of the enterprise have contributed to the conclusion of the sale of such goods or merchandise.

6. An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. However, when the activities of such agent are devoted wholly or almost wholly on behalf of that enterprise, he shall not be considered an agent of independent status within the meaning of this paragraph if the transactions between the agent and the enterprise were not made under arm's length conditions.

7. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.

ARTICLE 6

INCOME FROM IMMOVABLE PROPERTY (REAL PROPERTY)

1. Income derived by a resident of a Contracting State from immovable property (real property), including income from agriculture or forestry, situated in the other Contracting State may be taxed in that other State.

2. The term "immovable property" shall have the meaning which it has under the law of the Contracting State in which the property in question is situated. The term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships, boats and aircraft shall not be regarded as immovable property.

3. The provisions of paragraph 1 shall apply to income derived from the direct use, letting, or use in any other form of immovable property.

4. The provisions of paragraph 1 and 3 shall also apply to the income from immovable property of an enterprise and to income from immovable property used for the performance of independent personal services.

ARTICLE 7

BUSINESS PROFITS

1. The business profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the business profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.

2. Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the busness profits which it might be expected to make if it were a distinct and independent enterprise engaged in the same or similar activities under the same or similar conditions.

3. In determining the business profits of a permanent establishment, there shall be allowed as deductions expenses which are reasonably allocable to the income of that permanent establishment whether incurred in the State in which the permanent establishment is situated or elsewhere.

4. No business profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.

5. For the purposes of the preceding paragraphs, the business profits to be attributed to the permanent establishment shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.

6. Where business profits include items of income which are dealt with separately in other Articles of this Convention, the provisions of those Articles shall, except as otherwise specifically provided therein, not be affected by the provisions of this Article.

7. For the purposes of this Convention "business profits" means income derived from the conduct of any trade or business including the rental of tangible personal (movable) property and the furnishing of the personal services of another person, but not including income from the rental or licensing of cinematograph films or films or tapes used for radio or television broadcasting and not including income derived by an individual from the performance of personal services either as an employee or in an independent capacity.

ARTICLE 8

SHIPPING AND AIR TRANSPORT

1. Profits of an enterprise of a Contracting State from the operation in international traffic of ships or aircraft shall be taxable only in that State.

2. For purposes of this Article, profits from the operation in international traffic of ships or aircraft include profits derived from the rental of ships or aircraft if operated in international traffic by the lessee or if such rental profits are incidental to other profits described in paragraph 1.

3. Profits of an enterprise of a Contracting State from the use, maintenance or rental of containers (including trailers, barges and related equipment for the transport of containers) shall be taxable only in that State to the extent used for the transport of goods or merchandise in international traffic.

4. The provisions of paragraphs 1 and 3 shall also apply to profits from the participation in a pool, a joint business or an international operating agency.

ARTICLE 9

ASSOCIATED ENTERPRISES

1. Where an enterprise subject to the taxing jurisdiction of a Contracting State and any other enterprise are related and where such related enterprises make arrangements or impose conditions between themselves which are different from those which would be made between independent enterprises, any income, deductions, credits or allowances which would, but for those arrangements or conditions, have been taken into account in computing the income (or loss) of, or the tax payable by, one of such enterprises may be taken into account in computing the amount of the income subject to tax and the taxes payable by such enterprise.

2. Where a redetermination has been made by a Contracting State to the income of an enterprise in accordance with paragraph 1, then the other Contracting State shall, if it agrees with such redetermination and if necessary to prevent double taxation, make a corresponding adjustment to the income of the related enterprise in such other Contracting State. In the event the other Contracting State disagrees with such redetermination, the two Contracting States shall endeavor to reach agreement in accordance with Article 26 (Mutual Agreement Procedure).

3. For the purposes of this Convention an enterprise is related to another enterprise if either enterprise owns or controls directly or indirectly the other, or if any third person or persons own or control directly or indirectly both. For this purpose, the term "control" includes any kind of control, whether or not legally enforceable, and however exercised or exercisable.

ARTICLE 10

DIVIDENDS

1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

2. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident, and according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:

(a) 10 per cent of the gross income of the dividends if the beneficial owner is a company (other than a partnership) which owns, directly or indirectly, 10 per cent of the voting stock of the company paying the dividends;

(b) 15 per cent of the gross amount of the dividends in all other cases.

This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.

3. The term "dividends" as used in this Article means income from shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident.

4. The provisions of paragraphs 1 and 2 shall not apply if the recipient of the dividends, being a resident of a Contracting State, carries on business in the other Contracting State, of which the company paying the dividends is a resident, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment or fixed base. In such a case, the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), as the case may be, shall apply.

5. The income of a Jamaican company derived from the manufacture in Jamaica of approved products under the tax incentive legislation of Jamaica (as in effect on the date of signature of this Convention or as the competent authorities may agree pursuant to Article 26 (Mutual Agreement Procedure)) shall not be subject to the United States accumulated earnings tax. In addition, a company which is a resident of Jamaica shall be exempt from United States accumulated earnings tax if individuals (other than United States citizens) who are residents of Jamaica control, directly or indirectly, throughout the last half of the taxable year more than 75 per cent of the entire voting power in that company.

6. Where a company is a resident of a Contracting State, the other Contracting State may not impose any tax on the dividends paid by the company, except insofar as

(a) such dividends are paid to a resident of that other State; or

(b) the holding in respect of which the dividends are paid is effectively connected with a permanent establishment or a fixed base situated in that other State.

even if the dividends paid consist wholly or partly of profit or income arising in that other State.

ARTICLE 11

INTEREST

1. Interest arising in a Contracting State which is derived and beneficially owned by a resident of the other Contracting State may be taxed in that other State.

2. However, such interest may be taxed in the Contracting State in which it arises and according to the laws of that State, but the tax so charged shall not exceed 12.5 per cent of the gross amount of the interest.

3. Notwithstanding paragraphs 1 and 2, interest derived by

(a) a Contracting State or an instrumentality thereof (including the Bank of Jamaica, the Jamaica Development

Bank, the Jamaica Mortgage Bank, the Export-Import Bank of the United States, the Overseas Private Investment Corporation, the Federal Reserve Banks of the United States, and such other institutions of either Contracting State as the competent authorities may agree pursuant to Article 26 (Mutual Agreement Procedure); or

(b) a resident of a Contracting State with respect to debt obligations guaranteed or insured by that Contracting State or an instrumentality thereof

shall be exempt from tax by the other Contracting State.

4. The term "interest" as used in this Convention means income from debt-claims of every kind, whether or not secured by mortgage, and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums or prizes attaching to such securities, bonds or debentures, as well as income similar to income from money lent.

5. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the interest, being a resident of a Contracting State, carries on business in the other Contracting State in which the interest arises, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the debt-claim in respect of which the interest is paid is effectively connected with such permanent establishment or fixed base. In such a case the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), as the case may be, shall apply.

6. Interest shall be deemed to arise in a Contracting State when the payer is that State itself, a political subdivision, a local authority or a resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment or fixed base, then such interest shall be deemed to arise in the State in which the permanent establishment or fixed base is situated.

7. Where, by reason of a special relationship between the payer and beneficial owner or between both of them and some other person, the amount of the interest, having regard to the debt-claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such a case the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

ARTICLE 12

ROYALTIES

1. Royalties arising in a Contracting State which are derived and beneficially owned by a resident of the other Contracting State may be taxed in that other State.

2. However, such royalties may also be taxed in the Contracting State in which they arise and according to the laws of that State, but the tax so charged shall not exceed 10 per cent of the gross amount of the royalties.

3. The term "royalties" as used in this Convention means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work (including cinematograph films or films or tapes used for radio or television broadcasting), any patent, trade mark, design or model, plans, secret formula or process, or other like right or property, or for information concerning industrial, commercial or scientific experience. The term "royalties" also includes gains derived from the alienation of any such right or property which are contingent on the productivity, use, or disposition thereof but does not include payments for the use of tangible personal property.

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the royalties, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arise, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the royalties are paid is effectively connected with such permanent establishment or fixed base. In such a case the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), as the case may be, shall apply.

5. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties, having regard to the use, right or information for which they are paid, exceeds the amount which would have been agreed upon by the payer and the person deriving the royalties in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such a case the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

6. Royalties shall be deemed to arise in a Contracting State when the payer is that State itself, a political subdivision or a local authority thereof, or a resident of that State. However, where the right or property for which the royalties are paid is used within the United States or Jamaica, as the case may be, the royalties shall be deemed to arise in the State in which the right or property is used.

ARTICLE 13

CAPITAL GAINS

1. Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 (Income From Immovable Property (Real Property)) and situated in the other Contracting State may be taxed in that other State.

2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base regularly available to a resident of a Contracting State in the other Contracting State for the purpose of performing

independent personal services, including such gains from the alienation of such a permanent establishment (alone or of such fixed base), may be taxed in that other State.

3. Gains derived by an enterprise of a Contracting State from the alienation of ships, aircraft or containers operated by such enterprise in international traffic shall be taxable only in that State.

4. Jamaica may impose its transfer tax upon the alienation of property in accordance with the Transfer Tax Act as in effect on the date of signature of this Convention.

5. Gains derived by a resident of a Contracting State from the alienation of

(a) Stock of a company the value of which is derived principally from immovable property situated in the other Contracting State; or

(b) An interest in a partnership, trust, or estate the value of which is derived principally from immovable property situated in the other Contracting State

may be taxed in the other State. For the purpose of this paragraph, the term "immovable property" includes the stock of a company referred to in subparagraph (a) or an interest in a partnership, trust, or estate referred to in sub-paragraph (b).

6. Gains from the alienation of any property other than that referred to in paragraphs 1, 2, 3, 4 and 5 shall be taxable only in the Contracting State of which the alienator is a resident.

7. Nothing in this Convention shall affect the right of a Contracting State to levy, according to its domestic law, a tax on gains from the alienation of property derived by an individual who is a resident of the other Contracting State and who was a national of the first-mentioned State at any time during the ten-year period immediately preceding the close of the taxable year in which such property was alienated.

ARTICLE 14

INDEPENDENT PERSONAL SERVICES

1. Income derived by an individual who is a resident of a Contracting State from the performance of personal services in an independent capacity may be taxed by that Contracting State. Except as provided in paragraph 2, such income shall be exempt from tax by the other Contracting State.

2. Income derived by an individual who is a resident of a Contracting State from the performance of personal services in an independent capacity in the other Contracting State may be taxed by that other Contracting State, if:

(a) he has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities; in that case, only so much of the income as is attributable to that fixed base may be taxed in that other Contracting State;

(b) he is present in that other Contracting State for a period or periods aggregating 90 days or more in the taxable year; or

(c) the net income derived in the taxable year from residents of that other Contracting State for the performance of such services in the other Contracting State exceeds 5,000 United States dollars or its equivalent in Jamaican dollars.

ARTICLE 15

DEPENDENT PERSONAL SERVICES

1. Subject to the provisions of Articles 16 (Directors' Fees), 19 (Pensions, etc.) and 20 (Government Service), salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.

2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:

(a)(i) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in the taxable year concerned; (ii) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State; and (iii) the remuneration is not borne by a permanent establishment or a fixed base which the employer has in the other State, unless

(b) the net income derived in the taxable year by such resident from such employment exceeds 5,000 United States dollars or its equivalent in Jamaican dollars.

3. Notwithstanding the preceding provisions of this Article, remuneration derived in respect of an employment as a member of the regular complement of a ship or aircraft operated by an enterprise of a Contracting State in international traffic may be taxed only in that Contracting State.

ARTICLE 16

DIRECTORS' FEES

Directors' fees and similar payments derived by a resident of a Contracting State for services rendered in the other Contracting State as a member of the board of directors of a company which is a resident of the other Contracting State may be taxed in that other State, except where the amount of such fees and similar payments, not including expenses reimbursed to him or borne on his behalf, do not exceed four hundred United States dollars or its equivalent in Jamaican dollars per day for each day such resident is present in that other Contracting State for the purpose of performing such services.

ARTICLE 17

INVESTMENT OR HOLDING COMPANIES

If 25 percent or more of the capital of a company which is a resident of a Contracting State is owned directly or indirectly by individuals who are not residents of that State, and if by reason of special measures the tax imposed by that State on that company with respect to dividends, interest or royalties arising in the other Contracting State is substantially less than the tax generally imposed by the first-mentioned State on corporate business profits, then, notwithstanding the provisions of Articles 10 (Dividends), 11 (Interest), or 12 (Royalties), that other State may tax such dividends, interest or royalties. For the purpose of this Article, the source of dividends, interest or royalties shall be determined in accordance with paragraph 3 a), b), or

c) of Article 24 (Relief From Double Taxation).

ARTICLE 18

ARTISTES AND ATHLETES

1. Notwithstanding the provisions of Articles 14 (Independent Personal Services) and 15 (Dependent Personal Services), income derived by a resident of a Contracting State as an entertainer, such as a theatre, motion picture, radio or television artiste, or a musician, or as an athlete, from his personal activities as such exercised in the other Contracting State may be taxed in that other State, except where the amount of the gross receipts derived by such entertainer or athlete, not including expenses reimbursed to him or borne on his behalf, from such activities do not exceed four hundred United States dollars or its equivalent in Jamaican dollars per day, or five thousand United States dollars or its equivalent in Jamaican dollars in the taxable year.

2. Where income in respect of activities exercised by an entertainer or an athlete in his capacity as such accrues not to that entertainer or athlete but to another person, that income may, notwithstanding the provisions of Articles 7 (Business Profits), 14 (Independent Personal Services), and 15 (Dependent Personal Services), be taxed in the Contracting State in which the activities of the entertainer or athlete are exercised. For purposes of the preceding sentence, income of an entertainer or athlete shall be deemed not to accrue to another person to the extent that it is established that neither the entertainer or athlete, nor any person related thereto, has the right to participate directly or indirectly in the profits of such other person in any manner, including the receipt of deferred remuneration, bonuses, fees, dividends, partnership distributions or other distributions.

ARTICLE 19

PENSIONS, ETC.

1. Subject to the provisions of paragraph 2 of Article 20 (Government Service)—

(a) pensions and other similar remuneration beneficially derived by a resident of a Contracting State in consideration of past employment shall be taxable only in that State unless the past employment was performed in the other Contracting State while such person was a resident of that other State, in which case the pension and other similar remuneration may also be taxed in that other State; and

(b) social security payments and other public pensions paid by a Contracting State to a resident of the other Contracting State or a citizen of the United States shall be taxable only in the first-mentioned Contracting State.

2. Annuities beneficially derived by a resident of a Contracting State shall be taxable only in that State unless the annuity was purchased in the other Contracting State while such person was a resident of that other State, in which case the annuity may also be taxed in that other State. The term "annuities" as used in this paragraph means a stated sum paid periodically at stated times during life or during a specified number of years, under an obligation to make the payments in return for adequate and full consideration (other than services rendered).

3. Alimony paid to a resident of a Contracting State by a resident of the other Contracting State shall be exempt from tax in the other Contracting State. The term "alimony" as used in this paragraph means periodic payments made pursuant to a written separation agreement or a decree of divorce, separate maintenance, or compulsory support, which payments are taxable to the recipient under the laws of the State of which he is a resident.

4. Periodic payments for the support of a minor child made pursuant to a written separation agreement or a decree of divorce, separate maintenance, or compulsory support, paid by a resident of a Contracting State to a resident of the other Contracting State, shall be exempt from tax in both Contracting States.

ARTICLE 20

GOVERNMENT SERVICE

1. (a) Remuneration, other than a pension, paid by a Contracting State or a political subdivision or local authority thereof to an individual in respect of services rendered to that State or subdivision or authority shall be taxable only in that State; (b) However, such remuneration shall be taxable only in the other Contracting State if the services are rendered in that State and the individual is a resident of, and a national of, that State.

2. (a) Any pension paid by, or out of funds created by, a Contracting State or a political subdivision or local authority thereof to an individual in respect of services rendered to that State or subdivision or authority shall be taxable only in that State; (b) However, such pension shall be taxable only in the other Contracting State if the individual is a resident of, and a national of, that State who was a national of that State at the time the services were rendered.

3. The provisions of Articles 14 (Independent Personal Services), 15 (Dependent Personal Services), 16 (Directors' Fees), 18 (Artistes and Athletes) and 19 (Pensions, etc.) shall apply to remuneration and pensions in respect of services rendered in connection with a business carried on by a Contracting State or a political subdivision or local authority thereof.

ARTICLE 21

STUDENTS AND TRAINEES

1. Payments which a student, who is or was immediately before visiting a Contracting State a resident of the other Contracting State and who is present in the first-mentioned State for the purpose of his full-time education or training, receives for the purpose of his maintenance, education or training shall not be taxed in that State provided that such payments arise outside that State.

2. An individual who is a resident of a Contracting State at the time he becomes temporarily present in the other Contracting State and who is temporarily present in that other Contracting State as an employee or, or under contract with, a resident of the first-mentioned Contracting State, for the primary purpose of—

(a) acquiring technical, professional, or business experience from a person other than that resident of the first-mentioned Contracting State or a person related to such resident; or

(b) studying at a university or other recognized educational institution in that other State,

shall be exempt from tax by that other

Contracting State for a period not exceeding 12 consecutive months with respect to his net income from personal services in an amount not in excess of 7,500 United States dollars or its equivalent in Jamaican dollars for any taxable year.

3. Notwithstanding Article 4 (Residence), an individual to whom paragraph 1 or 2 applies and who immediately before visiting or becoming temporarily present in a Contracting State was a resident of the other Contracting State may elect as an alternative to the provisions of those paragraphs to be treated for all tax purposes of the first-mentioned State including this Convention, as a resident of that State. The election shall apply to all periods during the taxable year of the election and subsequent taxable years during which the individual qualifies under paragraph 1 or 2 and may not be revoked except with the consent of the competent authority of that State.

ARTICLE 22

TEACHERS AND RESEARCHERS

1. An individual who visits a Contracting State for a period not expected to exceed two years for the purpose of teaching or engaging in research at a university, college, or other recognized educational institution in that Contracting State, and who was immediately before that visit a resident of the other Contracting State, shall be exempt from tax by the first-mentioned Contracting State on any remuneration for such teaching or research for a period not exceeding two years from the date he first visits that State for such purpose. An individual shall be entitled to the benefits of this paragraph only once.

2. This Article shall apply to income from research only if such research is undertaken by the individual in the public interest and not primarily for the benefit of some other private person or persons.

ARTICLE 23

OTHER INCOME

1. Items of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing Articles of this Convention shall be taxable only in that State.

2. The provisions of paragraph 1 shall not apply if the person deriving the income, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed based situated therein, and the right or property in respect of which the income is paid is effectively connected with such permanent establishment or fixed base. In such a case the provisions of Article 7 (Business Profits), Article 14 (Independent Personal Services), or Article 18 (Artists and Athletes), as the case may be, shall apply.

3. Notwithstanding paragraph 1 and 2, items of income of a resident of a Contracting State not dealt with in the foregoing Articles of this Convention and arising in the other Contracting State may be taxed in that other State.

ARTICLE 24

RELIEF FROM DOUBLE TAXATION

1. In the case of the United States, double taxation shall be avoided as follows: In accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle hereof), the United States shall allow to a resident or citizen of the United States as a credit against the United States tax on income the appropriate amount of tax paid or accrued to Jamaica; and, in the case of a United States company owning at least 10 per cent of the voting power of a company which is a resident of Jamaica from which it receives dividends in any taxable year, the United States shall allow as a credit against the United States tax on income the appropriate amount of tax paid or accrued to Jamaica by that company with respect to the profits out of which such dividends are paid. Such appropriate amount shall be based upon the amount of tax paid or accrued to Jamaica, but the credit shall not exceed the limitations (for the purpose of limiting the credit to the United States tax on income from sources outside of the United States) provided by United States law for the taxable year. For purposes of applying the United States credit in relation to tax paid or accrued to Jamaica the taxes referred to in paragraphs 2(b) and 3 of Article 2 (Taxes Covered) shall be considered to be income taxes.

2. In the case of Jamaica, double taxation shall be avoided as follows: In accordance with the provisions and subject to the limitations of the law of Jamaica (as it may be amended from time to time without changing the general principle hereof), Jamaica shall allow to a resident of Jamaica as a credit against Jamaican tax on income the appropriate amount of tax paid or accrued to the United States; and in the case of a Jamaican company owning at least 10 per cent of the voting power of a company which is a resident of the United States from which it receives dividends in any taxable year, Jamaica shall allow as a credit against Jamaican tax on income the appropriate amount of tax paid or accrued to the United States by that company with respect to the profits out of which such dividends are paid. Such appropriate amount shall be based upon the amount of tax paid or accrued to the United States, but the credit shall not exceed the limitations (for the purpose of limiting the credit to the Jamaican tax on income from sources outside of Jamaica) provided by Jamaican law for the taxable year. For purposes of applying the Jamaican credit in relation to tax paid or accrued to the United States the taxes referred to in paragraphs 2(a) and 3 of Article 2 (Taxes Covered) shall be considered to be income taxes.

3. For the purpose of the preceding paragraphs of this Article, the source of income or profits shall be determined in accordance with the following rules:

(a) dividends described in Article 10 (Dividends) shall be deemed to arise in a Contracting State if paid by a company which is a resident of that State;

(b) interest, as defined in paragraph 2 of Article II (Interest), shall be deemed to arise in the State specified in paragraph 6 of Article II;

(c) royalties, as defined in paragraph 3 of Article 12 (Royalties), shall be deemed to arise in the State specified in paragraph 6 of Article 12;

(d) except for income or profits referred to subparagraphs a), b), or c), dividends and interest derived from a company described in paragraph 3 of Article 4 (Residence), and income described in paragraph 3 of Article 23 (Other Income), income or profits derived by a resident of a Contracting State which may be taxed in the other Contracting State (other than solely by reason of citizenship) in accordance with this Convention shall be deemed to arise in that other Contracting State.

ARTICLE 25

NON-DISCRIMINATION

1. Nationals of a Contracting State shall not be subjected in the other State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances are or may be subjected.

2. The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favorably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities.

3. Except where the provisions of paragraph 1 of Article 9 (Associated Enterprises), paragraph 7 of Article II (Interest), or paragraph 5 of Article 12 (Royalties) apply, interest, royalties and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State.

4. Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.

5. The provisions of this Article shall, in accordance with the provisions of paragraph 4 of Article 2 (Taxes Covered), apply to taxes of every kind and description imposed by a Contracting State or a political subdivision or local authority thereof.

6. Nothing contained in this Article shall be construed—

(a) as obliging either Contracting State to grant to individuals not resident in that State any personal allowances, reliefs or credits for taxation purposes which are by law available only to individuals who are so resident; or

(b) as preventing Jamaica from charging a higher rate of income tax under section 48(5) of the Income Tax Act of Jamaica on a life insurance company which is a resident of the United States than on a regionalized life assurance company.

ARTICLE 26

MUTUAL AGREEMENT PROCEDURE

1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident or national. A resident of a Contracting State who has a permanent establishment or a fixed base in the other Contracting State may present his case to the competent authority of either Contracting State.

2. The competent authority shall endeavor, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the conpetent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention. Any agreement reached shall be implemented notwithstanding the time limits in the domestic law of the Contracting States, provided that, in the case of Jamaica, the taxpayer or the competent authority of the United States gives notice within the time limits in the domestic law of Jamaica to the competent authority of Jamaica that there may be a claim for tax adjustment.

3. The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. In particular the competent authorities of the Contracting States may agree:

(a) to the attribution of income, deductions, credits, or allowances of an enterprise of a Contracting State to its permanent establishment situated in the other Contracting State;

(b) to the allocation of income, deductions, credits, or allowances between persons;

(c) to the characterization of particular items of income;

(d) to the application of source rules with respect to particular items of income; and

(e) to a meaning of a term.

They may also consult together for the elimination of double taxation in cases not provided for in the Convention.

4. The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement in the sense of the preceding paragraphs.

5. In cases where this Convention specifies a dollar amount, the competent authorities may agree to a high dollar amount.

ARTICLE 27

EXCHANGE OF INFORMATION AND ADMINISTRATIVE ASSISTANCE

1. The competent authorities of the Contracting States shall exchange such information as is necessary for carrying out the provisions of this Convention or of the domestic laws of the Contracting States concerning taxes covered by the Convention insofar as the taxation thereunder is in accordance with the Convention and, in addition, such information as is necessary for the prevention of fraud or tax evasion in relation to the taxes covered by the Convention. The exchange of information is not restricted by Article 1 (Personal Scope). Any information received by a Contracting State shall

be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) involved in the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes covered by the Convention. Such persons or authorities shall use the information only for such purposes. They may disclose information in public court proceedings or in judicial decisions.

2. If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall obtain the information to which the request relates in the same manner and to the same extent as if the tax of the first-mentioned State were the tax of that other State and were being imposed by that other State. If specifically requested by the competent authority of a Contracting State, the competent authority of the other Contracting State shall provide information under this Article in the form of depositions of witnesses and authenticated copies of unedited original documents (including books, papers, statements, records, accounts, or writings), to the same extent such depositions and documents can be obtained under the laws and administrative practices of such other State with respect to its own taxes.

3. In no case shall the provisions of paragraphs 1 and 2 be construed so as to impose on a Contracting State the obligation:

(a) to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;

(b) to supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;

(c) to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information, the disclosure of which would be contrary to public (order public).

4. Each of the Contracting States shall endeavour to collect on behalf of the other Contracting State such amounts as may be necessary to ensure that relief granted by the present Convention from taxation imposed by such other Contracting State does not enure to the benefit of persons not entitled thereto.

5. Paragraph 4 of this Article shall not impose upon either of the Contracting States the obligation to carry out administrative measures which are of a different nature from those used in the collection of its own tax, or which would be contrary to its sovereignty, security, public policy, or domestic law.

6. For the purpose of this Article, this Convention shall apply to taxes of every kind imposed by a Contracting State.

ARTICLE 28

DIPLOMATIC AGENTS AND CONSULAR OFFICERS

Nothing in this Convention shall affect the fiscal privileges of diplomatic agents or consular officers under the general rules of international law or under the provisions of special agreements.

ARTICLE 29

ENTRY INTO FORCE

1. This Convention shall be subject to ratification in accordance wih the applicable procedures of each Contracting State and instruments of ratification shall be exchanged at Washington as soon as possible.

2. The Convention shall enter into force upon the exchange of instruments of ratification and its provisions shall have effect:

(a) in respect of tax withheld at the source, to amounts paid or credited on or after the first day of the second month next following the date on which the Convention enters into force;

(b) in respect to other taxes, to taxable periods beginning on or after the first day of January next following the date on which the Convention enters into force.

3. Upon the coming into effect of this Convention, the extension to Jamaica, effective January 1, 1959, of the Convention of 16th April, 1945, between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, as modified by Supplementary Protocols of 6th June, 1946, 25th May, 1954, and 19th August, 1957, shall terminate. The provisions of the 1945 Convention, as amended, will cease to have effect with respect to the United States and Jamaica from the date on which the corresponding provisions of this Convention shall, for the first time, have effect according to the provisions of paragraph 2 of this Article.

ARTICLE 30

TERMINATION

1. This Convention shall remain in force until terminated by a Contracting State. Either Contracting State may terminate the Convention at any time after 5 years from the date on which the Convention enters into force provided that at least 6 months' prior notice of termination has been given through diplomatic channels. In such event, the Convention shall cease to have effect:

(a) in respect of tax withheld at the source, to amounts paid or credited on or after the first day of January next following the expiration of the 6 months' period;

(b) in respect of other taxes, to taxable periods beginning on or after the first day of January next following the expiration of the 6 months' period.

DONE at Kingston, Jamaica, in duplicate this 21st day of May, 1980.

LOREN LAWRENCE
For the United States of America.

HUGH SMALL
For Jamaica.

No. 141.

EXCELLENCY: I have the honor of commenting on the Convention between the Government of the United States of America and the Government of Jamaica for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, signed today. The following understandings were reached between the two Governments.

(1) In the process of negotiating this agreement, the delegation from Jamaica emphasized the necessity of

including in the Convention additional provisions which will create incentives to promote the flow of investment to Jamaica.

The United States delegation is not able to accept such provisions at this time. However, I wish to assure you that my Government realizes the importance your Government attaches to the increase of investments in Jamaica. Should circumstances change, including any changes in the manner in which the United States imposes income tax upon the income of United States investments in Jamaica, our Government would be prepared to reopen the discussions in order to reflect in this Convention provisions which would minimize the conflicts between the United States tax system and the incentive proposed by the Government of Jamaica to foreign investors and which are consistent with the income tax policies of the United States, including tax Convention policies, with respect to other developing countries.

(2) In the course of discussions leading to the conclusion of the Convention signed today, the Jamaican delegation expressed its desire that Article 24 (Non-Discrimination) be drafted so as not to prevent Jamaica from imposing special taxes in pursuance of its economic development program, even if these taxes might otherwise violate the provisions of Article 24. The United States delegation explained that it could not agree to such a provision before having the opportunity to examine the specific aspects of such legislation. The United States delegation believes, furthermore, that it would be inappropriate to grant to the competent authorities the power to expand in this way the scope of the Convention by administrative action.

I would like to take this opportunity to assure you, however, that if at some time in the future Jamaica should enact legislation which would contravene the provisions of Article 24 of the Convention, the United States would be prepared to reopen discussions with the Government of Jamaica to determine whether it would be appropriate to except such legislation from the scope of Article 24.

(3) During discussions involving the Convention, representatives of the Government of Jamaica expressed their concern about whether certain amounts received by the Government of Jamaica from companies extracting and refining bauxite in Jamaica would qualify for the United States foreign tax credit. The Government of Jamaica expressed the belief that such amounts are in satisfaction of liability for the Jamaican company profits tax. The Government of Jamaica also expressed a willingness to consider a revision of its taxation of bauxite income to impose a tax "in lieu of" its company profits tax within the meaning of section 903 of the United States Internal Revenue Code. The Government of Jamaica desired assurance that such an "in lieu of" tax would be covered by the Convention.

The United States delegation discussed with the delegation of the Government of Jamaica the foreign tax credit requirements of sections 901 and 903 of the Internal Revenue Code. The United States delegation agreed that the language now included in paragraph 3 of Article 2 (Taxes Covered) of the Convention covers amounts paid "in lieu of" the company profits tax (or income tax) of Jamaica, if the Government of Jamaica decides to impose such a tax in the future. It is understood that such an "in lieu of" tax would have to meet the requirements of sections 903 of the Internal Revenue Code of 1954 to be covered by the Convention.

Accept, Excellency, the renewed assurances of my highest consideration.

The Embassy of the United States of America, Kingston, May 21, 1980.

No. 714/09
His Excellency LOREN LAWRENCE,
Ambassador of the United States
of America.

EXCELLENCY. I have the honor to acknowledge receipt of your note of May 21, 1980 which reads as follows:

"I have the honor of commenting on the Convention between the Government of the United States of America and the Government of Jamaica for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, signed today. The following understandings were reached between the two Governments.

(1) In the process of negotiating this agreement, the delegation from Jamaica emphasized the necessity of including in the Convention additional provisions which will create incentives to promote the flow of investment to Jamaica.

The United States delegation is not able to accept such provisions at this time. However, I wish to assure you that my Government realizes the importance your Government attaches to the increase of investments in Jamaica. Should circumstances change, including any changes in the manner in which the United States imposes income tax upon the income of United States investments in Jamaica, our Government would be prepared to reopen the discussions in order to reflect in this Convention provisions which would minimize the conflicts between the United States tax system and the incentives proposed by the Government of Jamaica to foreign investors and which are consistent with the income tax policies of the United States, including tax Convention policies, with respect to other developing countries.

(2) In the course of discussions leading to the conclusion of the Convention signed today, the Jamaican delegation expressed its desire that Article 24 (Non-Discrimination) be drafted so as not to prevent Jamaica from imposing special taxes in pursuance of its economic development program, even if these taxes might otherwise violate the provisions of Article 24. The United States delegation explained that it could not agree to such a provision before having the opportunity to examine the specific aspects of such legislation. The United States delegation believes, furthermore, that it would be inappropriate to grant to the competent authorities the power to expand in this way the scope of the Convention by administrative action.

I would like to take this opportunity to assure you, however, that if at some time in the future Jamaica should enact legislation which would contravene the provisions of Article 24 of the Convention, the United States would be prepared to reopen discussions with the Government of Jamaica to determine whether it would be appropriate to except such legislation from the scope of Article 24.

(3) During discussions involving the Convention, representatives of the Government of Jamaica expressed their concern about whether certain amounts received by the Government of Jamaica from companies extracting and refining bauxite in Jamaica would qualify for the United States foreign tax credit. The Government of Jamaica expressed the belief that such amounts are in satisfaction of liability for the Jamaican company profits tax. The Government of Jamaica also expressed a willingness to consider a revision of its taxation of bauxite income to impose a tax "in lieu of" its company profits tax within the meaning of section 903 of the United States Internal Revenue Code. The Government of Jamaica desired assurance that such an "in lieu of" tax would be covered by the Convention.

The United States delegation discussed with the delegation of the Government of Jamaica the foreign tax credit requirements of sections 901 and 903 of the Internal Revenue Code. The United States delegation agreed that the language now included in paragraph 3 of Article 2 (Taxes Covered) of the Convention covers amounts paid "in lieu of" the company profits tax (or income tax) of Jamaica, if the Government of Jamaica decides to impose such a tax in the future. It is understood that such an "in lieu of" tax would have to meet the requirements of section 903 of the Internal Revenue Code of 1954 to be covered by the Convention.

Accept, Excellency, the renewed assurance of my highest consideration."

I have the honor to confirm that the foregoing understandings are in accord with the view of the Jamaican Government and are approved by it.

Accept, Excellence, the renewed assurances of my highest consideration.

HUGH SMALL,
Minister of Finance and Planning.

LETTER OF TRANSMITTAL

THE WHITE HOUSE,
August 4, 1980.

To the Senate of the United States:

I transmit herewith, for the advice and consent of the Senate to ratification, a Convention between the Government of the United States of America and the Government of Jamaica for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (the Convention), together with a related exchange of notes, signed at Kingston on May 21, 1980. I also transmit the report of the Department of State with respect to the Convention.

In general, the Convention follows the pattern of the United States model income tax convention, although there are some accommodations to Jamaica's status as a developing country. For example, business profits of an enterprise of one country, as in the model convention, may be taxed by the other only if they are attributable to a permanent establishment in the other country. In the proposed Convention, however, the definition of a permanent establishment is more broadly drawn. Similarly, in the United States model, an individual who is a resident of one State may be taxed by the other on income from personal services performed in the other State only if certain thresholds are passed, but in the proposed Convention, the time threshold is shorter for independent services and a dollar threshold has been added.

The exchange of notes sets forth certain understandings between the two Governments. It deals, among other matters, with the conditions under which the United States would allow a foreign tax credit for Jamaican income taxes on bauxite profits. The exchange of notes also confirms the fact that the Convention has been designed to cover a substitute tax which may be imposed by Jamaica "in lieu of" the corporate income tax on such profits if such substitute tax meets the requirement of section 903 of the Internal Revenue Code.

I recommend that the Senate give early and favorable consideration to the Convention and its advice and consent to ratification.

JIMMY CARTER.

LETTER OF SUBMITTAL

DEPARTMENT OF STATE,
Washington, July 17, 1980.

THE PRESIDENT,
The White House.

THE PRESIDENT: I have the honor to submit to you, with a view to its transmission to the Senate for advice and consent to ratification, the Convention between the Government of the United States of America and the Government of Jamaica for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (the Convention), together with a related exchange of notes, signed at Kingston on May 21, 1980.

The Convention will replace the extension in 1959 to Jamaica of the 1945 Income Tax Convention between the United States and the United Kingdom, as amended by Protocols of June 6, 1946, May 25, 1954, and August 16, 1957.

The Convention, in general, follows the pattern of the United States model income tax convention, although there are some deviations to accommodate Jamaica's status as a developing country. For example, as in the model convention, business profits of an enterprise of one country may be taxed by the other only if they are attributable to a permanent establishment in the other country. In the proposed Convention, however, the definition of a permanent establishment is more broadly drawn. Similarly, in the United States model, an individual who is a resident of one State may be taxed by the other on income from personal services performed in the other State only if certain tests are met, but in the proposed Convention, the time threshold is shorter for independent services and a dollar threshold is added. With respect to entertainers, the dollar threshold is lower than in the United States model.

Maximum rates of tax are established on a reciprocal basis for the taxation by the source country of dividends, interest and royalties, which, in general, exceed the rates specified in the United States model. The rates, however, are consistent with those established in other United States treaties with developing countries. For dividends, the maximum rate, in general, is 15 percent, as in the United States model, though the lower 10 percent rate provided for subsidiary dividends exceeds the rate specified in the United States model.

Interest is taxable at the source at a maximum rate of 12.5 percent, except that interest received, guaranteed, or insured by a Contracting State or instrumentality is exempt. Royalties, including motion picture royalties, are subject to a maximum rate of tax at source of 10 percent.

The Convention, with minor deviations from the model provisions, contains the usual rules relating to real property income, the treatment of students, pensioners and government employees, nondiscrimination, and administrative cooperation. The capital gain provision provides for tax on the alienation of stock of a company or interest in a partnership, trust or estate if the value of such entities are derived principally from immovable property located in the other Contracting State.

The Convention differs from the United States model by including provisions dealing with directors' fees and teachers.

The exchange of notes sets forth certain understandings between the two Governments. It deals, among other matters, with the conditions under which the United States would allow a foreign tax credit for Jamaican income taxes on bauxite profits. The exchange of notes also confirms the fact that the Convention has been designed to cover a substitute tax which may be imposed by Jamaica "in lieu of" the corporate income tax on such profits if such substitute tax meets the requirement of section 903 of the Internal Revenue Code.

The Convention will enter into force upon the exchange of instruments of ratification. The provisions of the Convention shall have effect:

(a) in respect of tax withheld at the source, to amounts paid or credited on or after the first day of the second month next following the date on which the Convention enters into force;

(b) in respect of other taxes, to taxable periods beginning on or after the first day of January next following the date on which the Convention enters into force.

Upon these provisions becoming effective, the corresponding provisions of the 1945 income tax convention with the United Kingdom, as amended, will cease to have effect between the United States and Jamaica.

A technical memorandum explaining in detail the provisions of the Convention is being prepared by the Department of the Treasury and will be submitted to the Senate Committee on Foreign Relations.

The Department of the Treasury, with the cooperation of the Department of State, was primarily responsible for the negotiation of the Convention. It has the approval of both Departments.

Respectfully submitted.

EDMUND S. MUSKIE.

PROTOCOL

AMENDING THE CONVENTION
BETWEEN THE GOVERNMENT OF
THE UNITED STATES OF AMERICA
AND THE GOVERNMENT OF
JAMAICA FOR THE AVOIDANCE OF
DOUBLE TAXATION AND THE
PREVENTION OF FISCAL EVASION
WITH RESPECT TO TAXES ON
INCOME, SIGNED AT KINGSTON ON
MAY 21, 1980.

The Government of the United States of America and the Government of Jamaica,

Desiring to conclude a Protocol to amend the Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed at Kingston on May 21, 1980,

Have agreed as follows:

ARTICLE I

Paragraph 3 of Article 1 (Personal Scope) of the Convention shall be deleted and replaced by the following:

"3. Notwithstanding any provisions of this Convention except paragraph 4 of this Article, a Contracting State may tax its residents (as determined under Article 4 (Residence)), and by reason of citizenship may tax its citizens, as if this Convention had not come into effect. In the case of the United States, the term "citizen" shall include a former citizen whose loss of citizenship had as one of its principal purposes the avoidance of income tax, but only for a period of 10 years following such loss."

ARTICLE II

Paragraph 2(a) of Article 10 (Dividends) of the Convention shall be deleted and replaced by the following:

"(a) 10 percent of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which owns, directly or indirectly, at least 10 percent of the voting stock of the company paying the dividends;"

ARTICLE III

Article 17 (Investment or Holding Companies) of the Convention shall be deleted and replaced by the following:

"ARTICLE 17 – LIMITATIONS AND BENEFITS

1. A person (other than an individual) which is a resident of a Contracting State shall not be entitled under this Convention to relief from taxation in the other Contracting State unless

(a) more than 75 percent of the beneficial interest in such person is owned, directly or indirectly, by one or more individual residents of the first-mentioned Contracting State; and

(b) the income of such person is not used in substantial part, directly or indirectly, to meet liabilities (including liabilities for interest or royalties) to persons who are residents of a State other than a Contracting State, other than any such persons who are individuals subject to tax in a Contracting State on their worldwide income by reason of citizenship.

A company that has substantial trading in its stock on a recognized exchange in a Contracting State is presumed solely for purposes of subparagraph (a), to be owned by individual residents of the Contracting State in which the company is resident, as determined under Article 4 (Residence).

2. Paragraph 1 shall not apply if it is determined that the acquisition, ownership or maintenance of such person and the conduct of its operations did not have as a principal purpose obtaining benefits under this Convention.

3. The requirements of paragraph 2 are satisfied, in particular, where a company resident in Jamaica and owned by individual residents of third States derives income with respect to which the company claims United States tax benefits under this Convention, the company does not use such

income in the manner described in paragraph 1(b) and:

(a) the company is engaged in business operations in Jamaica and the income with respect to which the company claims United States tax benefits is incidental to or derived in connection with the business operations in Jamaica; or

(b) the individuals owning the company are residents of countries that have income tax conventions in force with the United States and, pursuant to such conventions, the individuals would have been entitled to United States tax benefits the same as, or substantially similar to, the United States tax benefits claimed by the company under this Convention, had the individuals earned the income directly.

The provisions of this paragraph shall apply, *mutatis mutandis*, to a company resident in the United States and owned by residents of third States that derives income with respect to which Jamaican tax benefits are claimed under this Convention."

ARTICLE IV

There shall be added to Article 25 (Non-Discrimination) of the Convention a new paragraph 7, as follows:

"7. Expenses incurred by a citizen or resident of the United States in connection with attendance at a convention, seminar or similar meeting held in Jamaica shall be deductible for the purposes of taxation in the United States to the same extent as if the convention, seminar or similar meeting were held in the United States. This paragraph applies only to ordinary and necessary business expenses for:

(a) lodging, meals and the personal sustenance and comfort of the traveler while at the convention;

(b) registration at the convention and books and other similar materials necessary for attendance at the convention; and

(c) ground and air transportation to and from the convention site, but not in excess of the amount deductible under the laws of the United States with respect to transportation expenses incurred in connection with travel outside the United States."

ARTICLE V

1. This Protocol shall be subject to ratification in accordance with the applicable procedures of the United States and Jamaica and instruments of ratification shall be exchanged at Washington as soon as possible.

2. The Protocol shall enter into force upon the exchange of instruments of ratification and shall have effect in accordance with Article 29 (Entry Into Force) of the Convention.

In witness whereof the undersigned, being duly authorized thereto by their respective Governments, have signed this Protocol.

Done in duplicate at Kingston this 17th day of July 1981.

For the Government of
the United States of America:
LOREN LAWRENCE.

For the Government of Jamaica:
EDWARD P. G. SEAGA.

KINGSTON, *July 17, 1981*.

Rt. Hon. EDWARD P. G. SEAGA,
Minister of Finance and Planning,
Government of Jamaica,
Kingston, Jamaica.

DEAR MR. MINISTER: I have the honor of commenting on the Protocol signed today amending the Convention between the Governments of the United States of America and Jamaica for the Avoidance of Double Taxation and Prevention of Fiscal Evasion with respect to taxes on Income, signed on the 21st day of May, 1980 ("the Convention"). The following understandings with respect to the Protocol were reached between the two Governments.

1. During the discussions of Article III of the Protocol, the Jamaican delegation expressed concern about possible implications of new Article 17 (Limitations on Benefits) contained in Article III with respect to investments that might be made in Jamaica by residents of third countries. The United States delegation assured Jamaica that the purpose of new Article 17 is to deny benefits under the Convention where residents of third countries use the Convention with a principal purpose of obtaining U.S. or Jamaican tax benefits that such persons would not otherwise be entitled to, not to impede investments in Jamaica by residents of third countries.

In order to assure that the objectives of new Article 17 are met, the delegations of the United States and Jamaica agreed that the requirements of paragraph 2 of Article 17 are satisfied and that benefits are not denied under Article 17 in particular circumstances. The particular circumstances are where a company resident in Jamaica and owned by individual residents of third countries derives income with respect to which the company claims U.S. tax benefits under the Convention, the company does not use such income in the manner described in paragraph 1(b) of Article 17 and:

(i) the company is engaged in business operations in Jamaica and the income with respect to which the company claims U.S. tax benefits is incidental to or derived in connection with the business operations in Jamaica; or

(ii) the individuals owning the company are residents of countries that have income tax conventions in force with the United States and, pursuant to such conventions, the individuals would have been entitled to U.S. tax benefits the same as, or substantially similar to, the U.S. tax benefits claimed by the company under this Convention, had the individuals earned the income directly.

This agreement between the delegations is reflected in paragraph 3 of new Article 17. Paragraph 3 is not intended to suggest that the requirements of paragraph 2 cannot be met in other circumstances, nor to limit the factors that may be taken into account in determining whether "the acquisition, ownership or maintenance of such person and the conduct of its operations did not have as a principal purpose obtaining benefits under this convention," as provided in paragraph 2.

2. During discussions involving the Protocol, the delegations of the United States and Jamaica noted the past and present cooperation between the United States and Jamaica on legal assistance in criminal matters, including fiscal crimes, and the willingness of the United States and Jamaica to enter into negotiations designed to enhance and formalize that cooperation through modern treaties on extradition and mutual legal assistance on criminal matters.

Accept, Mr. Minister, the renewed assurances of my high consideration.

LOREN LAWRENCE.

The Embassy of the United States of America.

MINISTRY OF FINANCE
AND PLANNING,
Jamaica, 17th July, 1981.

HIS EXCELLENCY LOREN LAWRENCE,
Ambassador of the United States of America.

EXCELLENCY: I have the honour to acknowledge receipt of your Note of the 17th of July, 1981 which reads as follows:

"I have the honour of commenting on the Protocol signed today amending the Convention between the Governments of the United States of America and Jamaica for the Avoidance of Double Taxation and Prevention of Fiscal Evasion with respect to Taxes on Income, signed on the 21st day of May, 1980 ("the Convention"). The following understandings with respect to the Protocol were reached between the two Governments.

1. During the discussions of Article III of the Protocol, the Jamaican delegation expressed concern about possible implications of new Article 17 (Limitations on Benefits) contained in Article III with respect to investments that might be made in Jamaica by residents of third countries. The United States delegation assured Jamaica that the purpose of new Article 17 is to deny benefits under the Convention where residents of third countries use the Convention with a principal purpose of obtaining U.S. or Jamaican tax benefits that such persons would not otherwise be entitled to, not to impede investments in Jamaica by residents of third countries.

In order to assure that the objectives of new Article 17 are met, the delegations of the United States and Jamaica agreed that the requirements of paragraph 2 of Article 17 are satisfied and that benefits are not denied under Article 17 in particular circumstances. The particular circumstances are where a company resident in Jamaica and owned by individual residents of third countries derives income with respect to which the company claims U.S. tax benefits under the Convention, the company does not use such income in the manner described in paragraph 1(b) of Article 17 and:

(i) the company is engaged in business operations in Jamaica and the income with respect to which the company claims U.S. tax benefits is incidental to or derived in connection with the business operations in Jamaica; or

(ii) the individuals owning the company are residents of countries that have income tax conventions in force with the United States and, pursuant to such conventions, the individuals would have been entitled to U.S. tax benefits the same as, or substantially similar to, the U.S. tax benefits claimed by the company under this Convention, had the individuals earned the income directly.

This agreement between the delegations is reflected in paragraph 3 of new Article 17. Paragraph 3 is not intended to suggest that the requirements of paragraph 2 cannot be met in other circumstances, not to limit the factors that may be taken into account in determining whether "the acquisition, ownership or maintenance of such person and the conduct of its operations did not have as a principal purpose obtaining benefits under this Convention," as provided in paragraph 2.

2. During discussions involving the Protocol, the delegations of the United States and Jamaica noted the past and present co-operation between the United States and Jamaica on legal assistance in criminal matters, including fiscal crimes, and the willingness of the United States and Jamaica to enter into negotiations designed to enhance and formalize that co-operation through modern treaties on extradition and mutual legal assistance on criminal maters."

I have the honour to confirm that the foregoing understandings are in accord with the view of the Government of Jamaica and are approved by it.

Accept, Excellency, the renewed assurances of my highest consideration.

EDWARD P. G. SEAGA,
Prime Minister and
Minister of Finance and Planning.

LETTER OF TRANSMITTAL

THE WHITE HOUSE,
September 8, 1981.

To the Senate of the United States:

I transmit herewith, for the advice and consent of the Senate to ratification, the Protocol amending the Convention between the Government of the United States of America and the Government of Jamaica for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, together with a related exchange of notes, signed at Kingston on July 17, 1981. I also transmit the report of the Department of State with respect to the Protocol.

The Protocol was negotiated subsequent to Prime Minister Seaga's visit to this country in January, 1981. It strengthens the provisions of the Convention in order to limit potential abuse of the treaty in certain situations and to make more effective the means of denying treaty benefits to residents of third countries who establish a corporation in one Contracting State in order to obtain treaty benefits from the other Contracting State. The Protocol also permits United States citizens to deduct expenses incurred while attending business conventions in Jamaica.

I recommend that the Senate give early and favorable consideration to the Protocol and Convention and give its advice and consent to ratification.

RONALD REAGAN.

LETTER OF SUBMITTAL

DEPARTMENT OF STATE,
Washington, August 18, 1981.

The PRESIDENT,
The White House.

THE PRESIDENT: I have the honor to submit to you, with a view to its transmission to the Senate for advice and consent to ratification, the Protocol amending the Convention between the Government of the United States of America and the Government of Jamaica for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, together with a related exchange of notes, signed at Kingston on July 17, 1981.

The Protocol was negotiated subsequent to Prime Minister Seaga's visit to Washington in January, 1981, and reflects the understandings reached between you and the Prime Minister.

A central feature of the Protocol, (Article IV), adds a new provision to

Article 25 of the Convention (Nondiscrimination), to permit United States citizens to deduct expenses incurred while attending business conventions in Jamaica. Under the Protocol, expenses for any business convention held in Jamaica, if they are ordinary and necessary business expenses, will be deductible in the same way as if the convention were held in the United States.

Two provisions of the Protocol (Articles I and III) are designed to limit potential abuse of the Convention by denying treaty benefits in certain situations where benefits are not intended. Article I amends paragraph 3 of Article 1 of the Convention (Personal Scope), by providing that a former United States citizen who gives up his citizenship principally for tax avoidance purposes and resides in Jamaica will not be entitled to United States benefits under the Convention. Article III replaces Article 17 of the Convention and has as its purpose the denial of treaty benefits to residents of third countries who establish a corporation or other entity in one of the Contracting States for the principal purpose of obtaining treaty benefits from the other Contracting State. Although this was also the intent of Article 17 of the Convention as signed, the substitute language provided by Article III of the Protocol, makes the application of that provision more effective and less limited than the original.

The exchange of notes confirms understandings reached by the two Governments with respect to Article 17 of the Protocol, to ensure that its provisions are not used to impede bona fide investment in Jamaica by residents of third countries. In addition, the exchange of notes refers to past and present cooperation between the two countries on legal assistance in criminal matters, including fiscal crimes, and confirms their willingness to negotiate new treaties on extradition and mutual assistance on criminal matters.

The Protocol will enter into force upon the exchange of instruments of ratification and will have effect in accordance with the provisions of Article 28 of the Convention.

A technical memorandum explaining in detail the provisions of the Convention and the Protocol is being prepared by the Department of the Treasury and will be submitted to the Senate Committee on Foreign Relations.

The Department of the Treasury, with the cooperation of the Department of State, was primarily responsible for the negotiation of the Protocol. It has the approval of both Departments.

Respectfully submitted,

WILLIAM CLARK,
Acting Secretary of State.

Senate Executive Report No. 97-40

[Bracketed numerals indicate official report page numbers]

TAX CONVENTION (AND PROPOSED PROTOCOL) WITH THE GOVERNMENT OF JAMAICA

DECEMBER 9, 1981.

MR. PERCY, from the Committee on Foreign Relations, submitted the following report to accompany Ex. O, 96th Congress, 2d Session and Treaty Doc. 97-17, 97th Congress, 1st Session.

The Committee on Foreign Relations, to which was referred the Tax Treaty (and Proposed Protocol) with the Government of Jamaica [1] for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income (Executive O 96-2, and Treaty Doc. 97-17, respectively), as clarified by simultaneous Exchanges of Notes (collectively referred to as the proposed treaty), having considered the same, reports favorably thereon with a reservation and an understanding, and recommends that the Senate give its advice and consent to ratification thereof.

I. PURPOSE

There is presently no income tax treaty in force between the United States and Jamaica. The principal purpose of the proposed income tax treaty between the United States and Jamaica is to reduce or eliminate potential double taxation of income earned by citizens and residents of either country from sources within the other country and to prevent avoidance or evasion of the income taxes of the two countries. The proposed treaty is intended to promote closer economic cooperation between the two countries and to eliminate possible barriers to trade caused by overlapping taxing jurisdictions of the two countries.

II. BACKGROUND

The proposed treaty with Jamaica was signed on May 21, 1980, and was amplified by an Exchange of Notes signed the same day. The proposed protocol, together with a related exchange of notes, was signed on July 17, 1981. The proposed treaty would replace the 1959 extension to Jamaica of the 1945 income tax treaty between the United States and the United Kingdom, as subsequently modified. The treaty [2] and accompanying Exchange of Notes were transmitted to the Senate for advice and consent to ratification on August 4, 1980. The protocol and accompanying Exchange of Notes were transmitted to the Senate for advice and consent to ratification on September 8, 1981.

III. SUMMARY

The proposed treaty is similar to other recent U.S. income tax treaties and to the model income tax treaty of the Organization for Economic Cooperation and Development (OECD) in many respects, but in a number of respects it accords greater jurisdiction to tax to the country of source, rather than to the country of residence. In that regard it reflects Jamaica's status as a developing country and the influence of the United Nations model for income tax treaties between developing and developed countries.

As in other U.S. tax treaties the objectives of the treaty are principally achieved by each country agreeing to limit, in certain specified situations, its right to tax income derived from its territory by residents of the other. For example, the treaty contains the standard tax treaty provision that neither country will tax the business income derived from sources within that country by residents of the other unless the business activities in the taxing country are substantial enough to constitute a branch or other permanent establishment (Article 7). Similarly, the treaty contains the standard "commercial visitor" exemptions under which residents of one country performing personal services will not be required to file tax returns and pay tax in the other unless their contacts with the other exceed certain specified minimums (Article 14 and 15). Also, the proposed treaty provides that capital gains derived by residents of either country from sources within the other are generally to be taxed only by the country of residence and not by the country of source (Article 13), and that dividends, interest and royalties received by residents of one country from sources within the other are to be taxed at reduced rates by the country of source (Articles 10, 11, and 12).

---

[1] Page 257; Technical Explanation, page 291; Senate Executive O is not published.

In situations where the country of source retains the right under the proposed treaty to tax income derived by residents of the other country, the treaty generally provides for the relief by the country of residence of the potential double taxation through a foreign tax credit (Article 24).

The treaty contains the standard provision (the "savings clause") contained in U.S. tax treaties that each country retains the right to tax its citizens and residents as if the treaty had not come into effect (Article 1). In addition, it contains the standard provision that the treaty will not be applied to deny any taxpayer any benefits he would be entitled to under the domestic law of either country or under any other agreement between the two countries; that is, the treaty will generally be applied only to the benefit of taxpayers.

The treaty also contains standard nondiscrimination provisions and provides for exchanges of information and administrative cooperation between the tax authorities of the two countries to avoid double taxation and prevent fiscal evasion with respect to income taxes.

The proposed treaty contains a number of provisions that vary from the U.S. model and many U.S. income tax treaties. A number of these [3] provisions generally reflect U.S. concessions to Jamaica because it is a developing country.

(1) The proposed treaty does not cover U.S. excise taxes on insurance premiums paid to foreign insurers and on private foundations. Thus, the U.S. will continue to impose those taxes.

(2) The definition of permanent establishment is somewhat broader than that in the U.S. model and many existing U.S. treaties. The principal areas in which the proposed treaty departs from the U.S. model are the inclusion as a permanent establishment of a place of management, a store or sales outlet, construction projects lasting more than 183 days in a 12-month period (rather than the model 12 months), performing services through personnel for more than 90 days, and the maintenance of substantial equipment for more than 120 consecutive days. Also, the proposed treaty includes connected supervisory services in the time period of a construction project.

(3) The tax on direct investment dividends is limited to 10 percent in contrast with the 5 percent in the U.S. model.

(4) The United States is prohibited from imposing its so-called second withholding tax on dividends paid by Jamaican corporations earning significant business profits in the United States.

(5) The U.S. accumulated earnings tax will not apply to certain income of a Jamaican company derived under Jamaican tax incentive legislation.

(6) The tax at source on gross interest is limited to 12.5 percent rather than the zero rate in the U.S. model. The zero rate is rarely obtained.

(7) Royalties, including movie royalties, may be taxed at 10 percent of gross rather than the zero rate in the U.S. model. The zero rate is rarely obtained.

(8) Independent personal service income may be taxed if the person is present in a country for more than 90 days, in contrast to the U.S. model which requires presence for more than 183 days.

(9) Both dependent and independent personal service income may be taxed at source if the income exceeds a dollar threshold. The U.S. model does not contain a dollar threshold.

(10) The proposed treaty, as amended by the proposed protocol, contains the tightest provision found in any U.S. treaty that prevents third country use of treaties.

(11) The proposed treaty, as amended by the proposed protocol, gives U.S. taxpayers a deduction for attending business conventions in Jamaica.

(12) The proposed treaty, as submitted, also differs from U.S. internal law in its treatment of the gain from the sale of an interest in certain partnerships, trusts, and estates owning U.S. real estate.

IV. DATE OF ENTRY INTO FORCE AND TERMINATION

Entry into Force

The proposed treaty will enter into force upon the exchange of instruments of ratification. It will take effect with respect to income of taxable years beginning on or after the first day of January of the year after the year in which it enters into force and with respect to taxes payable at the source on or after the first day of the second month [4] after the month in which it enters into force. As the provisions of the proposed treaty come into effect, the corresponding provisions of the extension to Jamaica of the 1945 treaty between the United States and the United Kingdom will terminate.

The proposed protocol will also enter into force upon the exchange of instruments of ratification. It will take effect in accordance with the provisions of the treaty.

Termination

The proposed treaty will continue in force indefinitely, but either country may terminate it at any time after 5 years from its entry into force by giving at least 6 months' prior notice through diplomatic channels. Such a termination will be effective with respect to income of taxable years beginning (or, in the case of withholding taxes, amounts paid or credited) on or after January 1 next following the expiration of the 6-month period.

V. COMMITTEE ACTION

The Committee on Foreign Relations held public hearings on the proposed Jamaican tax treaty and the proposed protocol, and on other tax treaties, on September 24, 1981. The Committee heard testimony in opposition to the protocol from Baltasar Corrada, Resident Commissioner of Puerto Rico, and Ron de Lugo, the Congressional Delegate from the U.S. Virgin Islands. The Committee considered the proposed treaty and protocol on December 8, 1981 and ordered them favorably reported with a reservation and an understanding by a voice vote, with the recommendation that the Senate give its advice and consent to ratification of both instruments.

VI. COMMITTEE COMMENTS

The Committee on Foreign Relations approved the treaty subject to a reservation and an understanding. The reservation deals with Article 13, relating to real estate. The understanding deals with Article 27, relating to exchange of information. The Committee approved the protocol to the treaty, but expressed its concern with Article IV of the protocol, dealing with the deductibility of expenses incurred in attending a business convention in Jamaica.

Gain on the Disposition of Real Property

On November 26, 1980, Congress passed the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA), which generally subjects foreign persons to U.S. tax on disposition of U.S. real estate made after June 18, 1980. Also, foreign persons disposing of stock in a U.S. corporation having 50 percent or more of its gross asset value comprised of U.S. real property interest are subject to U.S. taxation. Also, foreign persons disposing of an interest in a partnership, trust, or estate are subject to U.S. tax to the extent that entity had an interest in U.S. real property. Finally, the distribution (liquidating or nonliquidating) of a U.S. real property interest by a foreign corporation is subject to U.S. tax. In general, the FIRPTA rules to override treaties but not until January 1, 1985.

[5] The treaty generally would be consistent with FIRPTA. However, as submitted, it contains a provision, in paragraph (5) of Article 13, that would restrict the right of United States to apply its legislation.

Under the legislation, a foreign person disposing of an interest in a partnership, trust, or estate is treated as disposing proportionately of its U.S. real property. Accordingly, a foreign person disposing of an interest in a partnership 35 percent of the assets of which consisted of U.S. real estate would be taxed on his gain equal to 35 percent of the gain of the disposition. The treaty, however, treats partnerships, trusts, and estates as entities and would only permit taxation of the gain on the disposition of an interest in those entities by a resident of Jamaica if more than 50 percent of its assets consisted of U.S. real property interests. This entity characterization of a partnership conflicts with those Code rules that treat partnerships as flow-through entities, and directly overrides FIRPTA. The two separate rules will add substantial complexity to an area of the tax law that is already complex.

In view of the substantial public and Congressional concern with foreign investment in U.S. real estate that lead to the enactment of FIRPTA, and in view of the Congressional concern with overriding those provisions in this treaty expressed to this Committee, the Committee believes that it would not be appropriate to override FIRPTA. The Committee believes that it was clearly the intent of Congress that the U.S. should tax foreign investors when they derive gain on the disposition of an interest in U.S. real estate, even when the foreigner is a resident of a treaty partner. Accordingly, the Committee recommends the following reservation be approved by the Senate:

> Notwithstanding the provisions of paragraph (5) of Article 13 of the convention (which relates to the taxation of gains from the alienation of shares of a corporation or of an interest in a partnership, estate, or trust, the property of which consists, directly or indirectly, principally of real property situated in one of the countries), gain derived by a resident of a Contracting State from the alienation or other disposition of an interest in a corporation, or an interest in a partnership, trust, or estate, which has an interest in real property located in the other Contracting State, or the assets of which are considered under the domestic law of that other Contracting State to consist, in whole or in part, of real property, or an interest therein, in that other State, may be taxed by that other State to the extent provided for by its domestic law. In addition, gain derived by a corporation which is a resident of a Contracting State upon the distribution including a distribution in liquidation or otherwise (of an interest in real property in the other Contracting State as determined under the domestic law of the other Contracting State) may be taxed by that other Contracting State to the extent provided for by its domestic law.

As used in the above reservation, and in all similar reservations, the term "principally" means 50 percent or more. Thus, an interest in a corporation is taxable under this reservation only if the fair market [6] value of its real property interests in a Contracting State equals or exceeds 50 percent of the fair market value of its world wide interests in real property plus any other of its assets used or held for use in a trade or business.

Congressional Access to Information Received Under the Treaty

The proposed treaty contains a provision (Article 27) found in all U.S. income tax treaties, that requires the exchange of information which is necessary to carry out the provisions of the treaty or of the domestic tax laws of the two countries. The treaty also contains a provision (Article 26), found in most U.S. income tax treaties, that authorizes the competent authorities of the two countries to consult together to attempt to alleviate individual cases of double taxation or cases of taxation not in accordance with the treaty.

The Exchange of Information Article of the treaty contains a provision that limits access to information received by the United States and the treaty partner under the treaty to persons involved in the assessment or collection of taxes. A similar provision in existing treaties has been interpreted by the IRS as precluding Congressional access, specifically General Accounting Office (GAO) access, to mutual agreement case files. The IRS has indicated that they would not change this view. Accordingly, the appropriate Congressional Oversight Committees and the GAO have been hampered in their recent attempts to audit the IRS administration of mutual agreement cases which may involve significant revenue. Treasury has stated that this problem will be taken care of in future treaties, and that they are attempting to work out the problem for existing treaties.

This issue is of significant concern to the Senate Finance Committee, the House Ways and Means Committee, and the Joint Committee on Taxation, which are charged with the responsibility for oversight of the IRS. The Committee believes that such access is permitted and that those Committees and the GAO should, pursuant to the procedures established in the Internal Revenue Code, have access to information exchanged under the treaties, including the mutual agreement case files, where they believe it is necessary to carry out their oversight functions. Accordingly, the Committee recommends the following understanding be approved by the Senate.

> That appropriate Congressional committees and the General Accounting Office shall be afforded access to the information exchanged under this treaty where such access is necessary to carry out their oversight responsibilities, subject only to the limitations and procedures of the Internal Revenue Code.

The effect of this understanding is to make clear that the treaty authorizes the Finance Committee, the Ways and Means Committee, and the Joint Committee on Taxation, as well as the GAO, to have access to all information received under the treaty.

Convention Expense Deduction

The proposed treaty, as amended by the proposed protocol, contains a provision (Article IV of the protocol, amending Article 25 of the [7] treaty) that permits U.S. taxpayers to deduct the expenses they incur for attending a convention in Jamaica to the extent that the expenses would be deductible if the convention were held in the U.S. Under U.S. law (Sec. 274(h)) a U.S. taxpayer is not permitted to deduct expenses of attending a convention outside of the United States, Canada, or Mexico unless the taxpayer can establish that the locality and the purpose, activities or residences of the active members of the sponsoring organization, justified the foreign location.

The proposed treaty, as amended by the proposed protocol, would permit a deduction for attendance at a convention held in Jamaica provided that the normal U.S. rules (such as business purpose) for attending conventions in the United States are met. The provision covers only the expenses incurred for meals, lodging, and the personal sustenance and comfort of the traveler, the registration fees, including fees for the cost of materials, and the ground and air transportation to and from the convention site. These expenses are allowed to the extent otherwise allowable under U.S. law. A similar provision is included in the proposed Canadian treaty.

This provision is controversial, and the Committee considered recommending that the Senate reject it. In the end, however, the Committee decided that it would be preferrable to consent to the provision in this case.

The Committee is concerned generally with granting deductions to U.S. persons by treaty in cases where the Congress has chosen not to do so under the Code and where the deductions have nothing to do with relief of double taxation. The convention expense provision grants a deduction to U.S. persons and does not deal with a problem of double taxation. Moreover, the objectives sought by this provision can be accomplished through domestic law. The Committee notes that the Chairman of both the Senate Finance Committee and the House Ways and Means Committee have expressed their general view that the United States should not give U.S. persons deductions by treaty.

The Committee is also concerned because the provision changes Code rules that were themselves changed at the end of 1980. Prior to the 1980 Code amendments a deduction for attending a convention in a foreign country was denied under the Code unless the relevance tests described above were met. In 1980, the Congress extended the deduction to expenses of attending a convention in Canada or Mexico. The Chairmen of both the Ways and Means and Finance Committees have expressed concern about the further extension of granting the deduction by this protocol.

The Committee is aware that the Protocol does contain other provisions which are advantageous to the United States, in particular, a far-reaching anti-treaty shopping provision and a commitment by Jamaica to enter into negotiations for the conclusion of a treaty on mutual assistance in criminal matters. The Committee is also aware that the convention deduction provision reflects a personal assurance made to President Seaga of Jamaica by President Reagan. It is regarded by the administration as an important step in its policy of assisting a valuable Caribbean ally. Therefore, the Committee is not disposed to oppose the Protocol or to enter a reservation on this issue.

[8] However, the Chairman of the Committee, Senator Percy, indicated that he did not favor further extensions of the convention deduction to other Caribbean countries. He noted that such extensions would not be likely to receive approval by the Senate and that other countries should not be misled into expecting such extensions.

Senator Dodd urged the Committee not to take a categorical view on further extensions of the convention deduction and to make it clear in its report that there is division within the Committee on this issue.

While expressing his strong support for the Jamaican treaty and protocol, he also stated his concern that barring the convention deduction for other nations in the Caribbean area would be seen as a discriminatory act at a time when the United States is attempting to develop closer working relations with these nations. In this regard, Senator Dodd introduced into the record a letter to him from Assistant Secretary of State Thomas Enders, which notes in part that it is Administration's view that extension of the deduction "could be a useful part of the President's Caribbean Basin Initiative. . . ." The text of this letter follows:

ASSISTANT SECRETARY
OF STATE
FOR INTER-AMERICAN
AFFAIRS,

Washington, D.C.,
December 7, 1981.

DEAR SENATOR DODD: In response to your interest in the Jamaica Tax Treaty and its implications for requests for similar treatment on conventions from other Caribbean Basin countries, I would like to summarize our current policy.

The Jamaica Tax Treaty is the only treaty currently pending which includes extension of North American treatment for business deductions while attending foreign conventions. Several countries in the Caribbean Basin have made an issue of requesting similar treatment, but we have no firm plans beyond Jamaica, nor have we made any commitments.

Extension of North American treatment to Caribbean and Central American countries in return for appropriate concessions in tax treaties could be a useful part of the President's Caribbean Basin Initiative, which is in an advanced state of development. Prior to reaching any decision on extensions to other countries, however, we would consult with appropriate Congressional committees, including the Foreign Relations Committee.

Sincerely,
THOMAS O. ENDERS.

The Committee agreed that the opposing points of view on this issue should be reflected in its report and that approval of the convention deduction in this instance should not be taken as an indication of Committee approval for any further extensions.

VII. BUDGET IMPACT

The Committee estimates that the effect of the proposed treaty on budget receipts will be negligible.

In accordance with the objectives of section 403 of the Budget Act, the Committee advises that the Director of the Congressional Budget [9] Office has examined the Committee's budget estimate and agrees that the effect on budget receipts will be negligible. In keeping with the spirit of section 308(a) of the Budget Act, and after consultation with the Director of the Congressional Budget Office, the Committee states that the treaty does not provide any new budget authority or any new or increased tax expenditures.

VIII. EXPLANATION OF TREATY PROVISIONS

Set forth below is an article-by-article explanation of the proposed income tax treaty between the United States and Jamaica, as modified by the proposed protocol.

Article 1. Personal Scope

The proposed treaty applies generally to residents of the United States and to residents of Jamaica, with specific exceptions designated in other articles. This follows other U.S. income tax treaties and the OECD model income tax treaty.

The proposed treaty also contains the customary rule that it may not be applied to restrict any benefits under domestic tax rules. This reflects the general rule that a treaty does not work to increase the tax burden of residents of either country beyond what it would be in the absence of the treaty--that is, the treaty only applies where it benefits taxpayers.

The proposed treaty contains the "saving clause" contained in all U.S. income tax treaties which provides, with specified exceptions, that the treaty is not to affect the taxation by the United States of its citizens and residents or the taxation by Jamaica of its citizens and residents. Residents for purposes of the treaty (and thus for purposes of the saving clause) include corporations and other entities as well as individuals (Article 4 (Residence)).

Under section 377, a former citizen whose loss of citizenship had as one of its principal purposes the avoidance of U.S. income tax will, in certain cases, be subject to tax for a period of ten years following the loss of citizenship. The treaty, as amended by the proposed protocol, contains the standard provision found in the U.S. model, and most recent treaties, specifically retaining the right to tax former citizens. Even without this provision, the Internal Revenue Service reaches this result. See Rev. Rul. 79-152, 1979-1 C.B. 237. (See also Article 13(7), which denies capital gain benefits regardless of the reason for expatriation.)

Exceptions to the saving clause are provided for the benefits conferred by the articles dealing with certain public pensions and child support payments (Article 19), relief from double taxation (Article 24), nondiscrimination (Article 25), and mutual agreement procedures (Article 26); thus, the benefits of those articles will be conferred by each country on its own citizens and residents as well as the citizens and residents of the other. In addition, the benefits conferred by the articles dealing with the taxation of income received by government employees (Article 20), students and trainees (Article 21), teachers (Article 22), and diplomatic and consular officials (Article 28) are to be provided by each country to its residents provided those residents are neither citizens of, nor have immigrant status in, that country.

[10] Consequently, except for the exceptions to the saving clause set forth above, U.S. citizens and residents generally benefit under the treaty as the result of the agreement by Jamaica to reduce its rate of tax on their income or exempt their income from tax rather than as the result of reductions in tax or exemptions by the United States. Even in this situation, if the tax which is foregone by Jamaica could have otherwise been claimed in full by the U.S. taxpayers as a foreign tax credit, the real beneficiary of the reduction or elimination of the Jamaican tax would, as a practical matter, be the U.S. Treasury rather than the U.S. taxpayer. Similarly, except as noted above, Jamaican citizens and residents benefit under the treaty only to the extent that the United States agrees to reduce its tax on their income or to exempt their income from tax.

Article 2. Taxes Covered

In the case of the United States, the proposed treaty applies to the Federal income taxes imposed under the Internal Revenue Code. However, it does not generally apply to the accumulated earnings tax or the personal holding company tax. Unlike the U.S. model treaty, it does not apply to the excise taxes imposed on insurance premiums paid to foreign insurers and with respect to private foundations. Thus, the United States will be able to continue to impose those taxes without restriction.

In the case of Jamaica, the treaty applies to the income tax, the company profits tax, and the transfer tax. These taxes are specifically designated as creditable income taxes for purposes of the U.S. foreign tax credit.

The proposed treaty also contains a provision generally found in U.S. income tax treaties to the effect that it will apply to substantially similar taxes which either country may subsequently impose. In particular, the treaty will apply to a tax imposed by Jamaica in lieu of the income tax or the company profits tax. As explained in the Exchange of Notes accompanying the proposed treaty, the Jamaican negotiators expressed concern about whether certain amounts received by Jamaica from companies extracting and refining bauxite in Jamaica would qualify for the United States foreign tax credit. The United States negotiators agreed that the Convention would cover amounts paid "in lieu of" the company profits tax (or income tax) of Jamaica, if the Government of Jamaica decides to impose such a tax in the future, as long as that tax meets the requirements of creditability under U.S. law (Code sec. 903).[1]

Each country is obligated under the treaty to notify the other of any changes it makes in its tax laws and of any official published material concerning the treaty, including explanations, regulations, rulings, and judicial determinations.

Additionally, the nondiscrimination provisions (Article 25) of the treaty apply to all taxes of every kind imposed at the national, state, or local level by the United States or Jamaica. The exchange of information and administrative assistance provisions (Article 27) of the proposed treaty will also apply to all taxes of every kind imposed by the two countries at the national level.

[11] *Article 3. General Definitions*

Certain of the standard definitions found in most U.S. income tax treaties are contained in the proposed treaty.

Under the proposed treaty, the term "United States" means the United States of America and when used in a geographical sense includes the States and the District of Columbia, the territorial waters of the United States, and any area outside the States and the District of Columbia which in accordance with international law and the laws of the United States is an area within which the rights of the United States with respect to the natural resources of the seabed and subsoil may be exercised. This reference to the seabed and subsoil is not contained in the latest U.S. model definition. However, the United States reads the definition in the model as being no different than the definition in this proposed convention.

The term "Jamaica" means the island of Jamaica, the Morant Cays, the Pedro Cays and their Dependencies and when used in a geographical sense similarly includes the territorial waters of Jamaica and its natural resource jurisdiction.

A "national" of either country is defined to include both a citizen of that country and also any legal entity such as a corporation, trust, estate, partnership, or association which is established under the laws of that country. A "company" is defined as a corporation or other entity treated as a corporation for tax purposes. An "enterprise" of a country is defined as an enterprise or undertaking carried on by a resident of that country. Although the treaty does not define the term "enterprise," it would have the same meaning that it has in other U.S. tax treaties—the trade or business activities undertaken by an individual, partnership, corporation, or other entity.

The proposed treaty also contains the standard provision that, unless the context otherwise requires or the competent authorities of the two countries establish a common meaning, any terms are to have the meaning which they have under the applicable tax laws of the country applying the treaty.

Article 4. Residence

The benefits of the proposed treaty generally are available only to a resident of one of the countries as that term is defined in the treaty.

Under U.S. law, residence of an individual is important because a resident alien is taxed on his worldwide income, while a nonresident alien is taxed only on U.S. source income and on his income that is effectively connected with a U.S. trade or business. The Code, however, does not define the term. Instead, IRS regulations state that an alien is a resident of the United States if he is actually present in the U.S. and is not a mere transient or sojourner. Whether he is a transient is determined by his intentions as to the length and nature of his stay. (See Treas. Reg. §871-2(b).) A corporation is resident in the U.S. if it is organized in the U.S. The proposed convention would provide a more precise definition of residence.

Under the treaty, a person other than a company, is resident in a country for purposes of the treaty if it is resident in that country for purposes of that country's tax. However, in the case of a partnership, estate or trust, the entity is treated as a resident only to the extent that the income derived by the entity is subject to that country's tax as [12] the income of a resident either in its hands or in the hands of its partners or beneficiaries.

A company is treated as a resident of Jamaica if it is managed and controlled in Jamaica, and as a resident of the United States if it is created or organized under the laws of the United States or a political subdivision. A company which is managed and controlled in Jamaica but organized under U.S. law is a "dual resident." Such a company is considered to be outside the scope of the treaty except for purposes of paragraph 2 of Article 10 (Dividends), Article 25 (Non-discrimination), Article 26 (Mutual agreement procedure), Article 27 (Exchange of information and administrative assistance) and Article 29 (Entry into force). A company organized under Jamaican law but managed and controlled in the United States would not be a resident of either country.

A set of rules is provided to determine residence in the case of an individual who, under the basic treaty definition, would be considered to be a resident of both countries. In the case of a dual resident individual, the individual will be deemed for all purposes of the treaty to be a resident only of the country in which he has his permanent home (where an individual dwells with his family), his center of vital interests (his closest economic and personal relations), his habitual abode, or his citizenship. If the residence of an individual cannot be determined by these tests, applied in the order stated, the competent authorities of the countries will settle the question by mutual agreement. In the case of a dual resident person, other than an individual or a company (e.g., a dual resident partnership, trust, or estate), the residence of the person and the mode of application of the treaty will be determined by the competent authorities.

---

[1] U.S. law allows a foreign tax credit for foreign income taxes, and for taxes paid "in lieu of" an income tax otherwise generally imposed by the foreign country.

Article 5. Permanent Establishment

The proposed treaty contains a definition of permanent establishment which follows the pattern of other recent U.S. income tax treaties and the U.S. and OECD model tax treaties. However, in order to reflect Jamaica's status as a developing country, a number of concessions are made to the principle of taxation of income at the source. Some of these concessions reflect positions suggested by the United Nations model tax treaty between developed and developing countries. The permanent establishment concept is one of the basic devices used in income tax treaties to avoid double taxation.

Generally, a resident of one country is not taxable on its business profits by the other country unless those profits are attributable to a permanent establishment of the resident in the other country. In addition, the permanent establishment concept is used to determine whether the reduced rates of, or exemptions from, tax provided for dividends, interest, and royalties are applicable.

The principal areas in which the Jamaican treaty departs from the U.S. model are in its inclusion in the permanent establishment definition of a sales outlet, construction projects lasting more than 183 days (rather than 12 months), an individual performing services more than 90 days, and maintenance of equipment more than 120 days. Also, the inclusion in the time period of supervisory activity connected with construction or natural resource type activity is a departure from the U.S. model.

[13] In general, a fixed place of business through which a resident of one country engages in business in the other country is considered a permanent establishment. This includes a place of management; a branch; an office; a factory; a workshop; a store or premises used as a sales outlet; a warehouse, in relation to a person providing storage facilities for others; or a mine, an oil or gas well, a quarry, or other place of extraction of natural resources. It also includes any building site, construction, assembly, installation, or dredging project, or drilling rig or ship used for the exploration or development of natural resources, but only if the site, project, etc., lasts for more than 183 days in any twelve-month period (including the period of any supervisory activity connected therewith). A permanent establishment will not exist in any taxable year in which such a site, project or activity is in that country for a period or periods aggregating less than 30 days.

An enterprise will also have a permanent establishment if it furnishes services, including consultancy, management and technical, and supervisory services in a country through employees or other personnel, but only if these continue within that country for more than 90 days in any twelve-month period. No permanent establishment will result, however, in any taxable year in which these services are performed less than 30 days. However, the 90-day minimum requirement does not apply, and a permanent establishment will result, if the services are performed for a related enterprise (Article 9(3)). Such a permanent establishment is not necessarily also a permanent establishment of the related enterprise (Article 5(7)).

Finally, an enterprise will have a permanent establishment if it maintains substantial equipment or machinery in a country but only if the equipment or machinery is maintained in that country for a period of more than 120 consecutive days. No permanent establishment will, however, exist in any taxable year in which the equipment or machinery is maintained within that country for less than 30 days.

This general rule is modified to provide that a fixed place of business which is only used for any or all of a number of specified activities will not constitute a permanent establishment. These activities include the use of facilities for storing, displaying, or delivering merchandise belonging to the enterprise and the maintenance of a stock of goods belonging to the enterprise for purposes of storage, display, or delivery, except where the goods or merchandise are held for sale by the enterprise in a store or premises used as a sales outlet. Also included are maintenance of goods for processing by another person, or the purchase of goods or merchandise, collection of information, or any other preparatory or auxiliary activities for the enterprise.

Even if an enterprise of one country does not have a permanent establishment in the other country under the foregoing rules, it may still be treated as having one to the extent that goods or merchandise are sold by or on behalf of the enterprise for use, consumption, or disposition in that other country. This special rule applies only if the goods or merchandise are either (a) subjected to processing in that other country by another person (whether or not purchased in that other country); or (b) purchased in that other country and not subjected to processing outside that other country.

If an enterprise of one country maintains an agent in the other country who has, and regularly exercises, the authority to enter into [14] contracts in that other country in the name of the enterprise, then the enterprise will be deemed to have a permanent establishment in the other country with respect to the activities which the agent undertakes on its behalf. This rule does not apply where the contracting authority is limited to those activities (described above) such as storage, display, or delivery of merchandise which are excepted from the definition of permanent establishment. However, the enterprise will be treated as having a permanent establishment if the agent habitually maintains in that other country a stock of goods or merchandise from which he regularly makes deliveries on behalf of the enterprise and additional activities conducted in that other country on behalf of the enterprise have contributed to the conclusion of the sale of the goods or merchandise.

The proposed treaty contains the

ual provision that the agency rule ill not apply if the agent is a broker, eneral commission agent, or other gent of independent status acting in e ordinary course of its business. lowever, this rule is modified to pro- ide that when the activities of the gent are devoted wholly or almost vholly on behalf of that enterprise, he vill not be considered an agent of ndependent status if the transactions etween the agent and the enterprise vere not made under arm's length onditions.

The fact that a company which is a resident of one country controls or is controlled by a company which is a resident of the other country or which carries on business in that other country (whether through a permanent establishment or otherwise) will not of itself constitute either company a permanent establishment of the other.

Article 6. Income from Immovable Property (Real Property)

The proposed treaty provides that income from real property (including income from agriculture or forestry) may be taxed in the country where the real property or natural resources are located. For purposes of the treaty, real property will generally have the meaning provided under the laws of the country where the property is located, but will in any case include property which is accessory to real property, livestock and equipment used in agriculture and forestry, and rights to real property. Ships, boats, and aircraft will not be considered real property.

Income from real property includes income from the direct use or renting of the property. It also includes royalties and other payments in respect of the exploitation of natural resources (e.g., oil wells). It does not include interest on loans secured by real property. Under Article 13 (Capital Gains), gains on the sale, exchange, or other disposition of the property may also be taxed by the country where the property is located.

Generally, gain realized by a nonresident alien or a foreign corporation from the sale of a capital asset is not subject to U.S. tax unless the gain is effectively connected with the conduct of a U.S. trade or business or, in the case of a nonresident alien, he is physically present in the United States for at least 183 days in the taxable year. However, under the Foreign Investment in Real Property Tax Act of 1980, as amended, a nonresident alien or foreign corporation is taxed by the United States on gain from the sale of U.S. real estate, and gain [15] from the sale of stock in a U.S. real property holding corporation, as if gain was effectively connected with a trade or business conducted in the U.S. The capital gain provision of the treaty (Article 13) would not in any way restrict the right of the United States to tax the gain from the sale of U.S. real estate and stock of U.S. real property holding corporations under the provisions of the 1980 legislation or any similar but later enacted legislation. It does, however, change the U.S. treatment of gains from the disposition of an interest in a partnership, trust or estate holding an interest in U.S. real estate (see discussion of Article 13). It also retains the right of the U.S. to impose relevant reporting or withholding requirements.

The proposed treaty does not include a provision in the U.S. model which would allow an election to be taxed on real estate income on a net basis. Such a provision is already included in the Internal Revenue Code (secs. 871(d) and 882(d)).

Article 7. Business Profits

United States law separates the business and investment income of a nonresident alien or foreign corporation. A nonresident alien or foreign corporation is subject to a flat 30 percent (or lower treaty rate) rate of tax on its U.S. source income if that income is not effectively connected with the conduct of a trade or business within the United States. The regular individual or corporate rates apply to U.S. source income which is effectively connected with the conduct of a trade or business within the United States.

The taxation of income as business or investment income varies depending upon whether the income is U.S. or foreign. U.S. source periodic income, such as interest, dividends, rents, wages, and capital gains is effectively connected with the conduct of a trade or business within the United States only if the asset generating the income is used in or held for use in the conduct of the trade or business, or if the activities of the trade or business were a material factor in the realization of the income. All other U.S. source income is treated as effectively connected income.

Foreign source income is effectively connected income only if the foreign person has an office or other fixed place of business in the United States and the income is attributable to that place of business. Only three types of foreign source income can be effectively connected income; rents and royalties derived from the active conduct of a licensing business; dividends, interest, or gain from stock or debt derived in the active conduct of a banking, financing or similar business in the United States; and certain sales income attributable to a United States sales office.

Except in the case of a dealer, the trading in stocks, securities or commodities in the United States for one's own account does not constitute a trade or business in the United States and accordingly income from those activities is not taxed by the U.S. as business income. This concept includes trading through a U.S. based employee, a resident broker, commission agent, custodian or other agent or trading by a foreign person physically present in the United States.

The proposed treaty generally follows the U.S. model, other recent treaties, and the OECD model. Under the proposed treaty, business [16] profits of an enterprise of one country are taxable in the other country only to the extent they are attributable to a permanent establishment in the other country through which the enterprise carries on business. This is one of the basic limitations on a source country's right to tax income of a nonresident.

The taxation of business profits under the proposed treaty differs from United States rules for taxing business profits primarily in requiring more than merely being engaged in trade or business before a country can tax effectively connected business profits. Under the Internal Revenue Code, all that is necessary for business profits to be taxed is that a trade or business be carried on in the United States. Under the proposed treaty, on the other hand, some level of fixed place of business must be present.

Under the proposed treaty, business profits of an enterprise of one country are taxable in the other country only to the extent they are attributable to a permanent establishment in the other country through which the enterprise carries on business.

The business profits of a permanent establishment are determined on an arm's-length basis. Thus, there is to be attributed to it the business profits which would reasonably be expected to have been derived by it if it were an independent entity engaged in the same or similar activities under the same or similar conditions and dealing at arm's-length with the resident of which it is a permanent establishment.

In computing taxable business profits, deductions are allowed for expenses, wherever incurred, which are reasonably allocable to the permanent establishment. Such deductions would include, for example, a reasonable allocation of executive and general administrative expenses, interest, research and development which are incurred for purposes of the enterprise as a whole, or for that part of the enterprise that includes the permanent establishment.

Business profits will not be attributed to a permanent establishment merely by reason of the purchase of merchandise by the permanent establishment for the account of the enterprise. Thus, where a permanent establishment purchases goods for its head office, the business profits attributed to the permanent establishment with respect to its other activities will not be increased by a profits element on its purchasing activities.

Where business profits include items of income which are dealt with separately in other articles of the treaty, those other articles, and not the business profits article, will govern the treatment of those items of income. Unlike the U.S. model treaty, the proposed treaty provides that film royalties are not business profits. Thus, those royalties may be subject to tax (Article 12) even though the recipient has no permanent establishment in the taxing country.

Article 8. Shipping and Air Transport

As a general rule, the United States would tax the U.S. source income of a foreign person from the operation of ships or aircraft to or from the United States. An exemption from U.S. tax is provided if the ship or aircraft is documented under the laws of a foreign country that grants an equivalent exemption to the U.S. citizens and corporations. The United States has entered into agreements with a number [17] of countries under which that country grants an exemption which results in the United States exempting that country's shipping. Under the present treaty, U.S.-flag vessels operated by U.S. persons are exempt from Jamaican tax.

The proposed treaty provides that income which is derived by an enterprise of either country from the operation of ships and aircraft in international traffic shall be exempt from tax by the other country. International traffic means any transportation by ship or aircraft, except where the transportation is solely between places in the other country (Article 3(1)(d) (General definitions)). Unlike the present treaty, the exemption applies whether or not the ships or aircraft are registered in the first country. Thus, for example, Jamaica would not tax the income of a U.S. person operating a Liberian-flag vessel.

The exemption for shipping and air transport profits applies to profits from the rental of ships or aircraft if operated in international traffic by the lessee or if such rental profits are incidental to the actual operation of ships and aircraft in international traffic. Income from the operation in international traffic of ships or aircraft also includes income derived from the use, maintenance, or rental of containers, trailers for the inland transportation of containers, and other related equipment where the equipment is used to transport goods and merchandise in international traffic. The shipping and air transport provisions also apply to profits from participation in a pool, a joint business, or an international operating agency.

Article 9. Associated Enterprises

The proposed treaty provides that, if an enterprise subject to the taxing jurisdiction of a treaty country and any other enterprise are related and make arrangements or impose conditions between themselves which are different from those which would be made between independent persons, then any income, deductions, credits, or allowances which would, but for those arrangements or conditions, have been taken into account in computing the income (or loss) of, or the tax payable by, one of these enterprises, may be taken into account in computing the amount of income subject to tax and the taxes payable by that enterprise. An enterprise is related to another enterprise if either enterprise owns or controls directly or indirectly the other, or if any third person or persons own or control directly or indirectly both. For this purpose, the term "control" includes any kind of control, whether or not legally enforceable, and however exercised or exercisable. Thus, the treaty does not in any way limit the authority of the Internal Revenue Service to allocate or apportion income, deductions, credits, or allowances between related parties under section 482 of the Internal Revenue Code in situations where it determines that the allocation is necessary in order to prevent the evasion of taxes or clearly to reflect the income of the related parties.

Where an adjustment has been made by one treaty country in accordance with this provision and if necessary to prevent double taxation, the other country is, if it agrees with the adjustment, to make a corresponding adjustment to the income of the related enterprise in that other country. If the second country disagrees, however, the competent authorities will attempt to reach an agreement (Article 26).

[18] *Article 10. Dividends*

As a general rule, the United States imposes a 30-percent tax ("withholding tax") on dividends paid to foreign persons by U.S. corporations and certain foreign corporations earning more than half of their income from a U.S. business. Under the proposed treaty this tax, and Jamaica's similar tax, would be reduced.

Under the proposed treaty, each country may tax dividends paid by its companies to shareholders resident in the other (i.e., they may impose a dividend withholding tax on shareholders resident in the other country). The rate of tax is limited to 15 percent if the beneficial owner is a resident of the other country. However, it is limited to 10 percent (as contrasted with 5 percent in the U.S. model treaty) in the case of dividends paid to a company which directly or indirectly owns at least 10 percent of the voting stock of the company making the dividend distribution. This reduced withholding rate applies even in the case of a "dual resident" corporation.

Neither country can tax dividends paid by companies of the other except insofar as (a) the dividends are paid to residents of the country imposing the tax, or (b) the dividends are effectively connected with a permanent establishment or a fixed base in the taxing country. This provision waives the U.S. "second withholding tax" on dividends paid by foreign companies earning half of their income from U.S. business. The U.S. model would allow a tax where at least 50 percent of the company's gross income was attributable to a permanent establishment in the taxing country, to the extent the dividends are paid out of the profits derived from the permanent establishment.

The reduced rates of tax on dividends will apply unless the recipient has a permanent establishment (or fixed base in the case of an individual performing independent personal services) in the source country and the dividends are effectively connected with the permanent establishment (or fixed base). Dividends effectively connected with a permanent establishment are to be taxed as business profits (Article 7). Dividends effectively connected with a fixed base are to be taxed as income from the performance of independent personal services (Article 14).

The proposed treaty also provides that the income of a Jamaican company derived from the manufacture in Jamaica of approved products under the tax incentive legislation of Jamaica (as in effect on the date of signature of the treaty or as the competent authorities may agree pursuant to Article 26 (Mutual Agreement Procedure)) will not be subject to the United States accumulated earnings tax. In addition, a company which is a resident of Jamaica will be exempt from United States accumulated earnings tax if individuals (other than United States citizens) who are residents of Jamaica control, directly or indirectly, throughout the last half of the taxable year more than 75 percent of the entire voting power in that company.

Article 11. Interest

The U.S. imposes a 30-percent tax on U.S. source interest paid to foreign persons under the same rules that are applicable to dividends. U.S. source interest generally is interest on debt obligations of U.S. persons, but not interest on deposits in banks. Bank account interest [19] of a foreign person is thus exempt from U.S. tax. U.S. source interest also includes interest paid by a foreign corporation if at least 50 percent of the gross income of the foreign corporation, in the prior three year period, was effectively connected with a U.S. trade or business of that corporation.

Each country may tax interest income of its residents arising in the other country. However, the interest may also be taxed in the country in which it arises at a rate not exceeding 12.5 percent. This contrasts with the U.S. position, rarely achieved, that interest should be exempt from tax at source.

However, in certain situations, interest income will be exempt from withholding. First, interest is exempt if derived by the government of one of the treaty countries or an instrumentality thereof (including the Bank of Jamaica, the Jamaica Development Bank, the Jamaica Mortgage Bank, the Export-Import Bank of the United States, the Overseas Private Investment Corporation, the Federal Reserve Banks of the United States, and such other institutions of either country as the competent authorities may agree pursuant to Article 26 (Mutual Agreement Procedure)). It is understood, however, that the competent authorities will not exercise this authority except in the case of institutions substantially similar to those enumerated. Also exempted is interest derived by a resident of one country on debt which is guaranteed or insured by the government of that country or its instrumentality.

Interest generally "arises" in a country when the payer is that country's government, a political subdivision, a local authority or a resident of that country. Where, however, the person paying the interest, whether he is a resident or not, has in a treaty country a permanent establishment or a fixed base in connection with which the indebtedness on which the interest is paid was incurred, and the interest is borne by the permanent establishment or fixed base, then the interest will be deemed to arise in the country in which the permanent establishment or fixed base is situated.

The reduced withholding rate on interest will apply unless the recipient has a permanent establishment or fixed base in the source country and the interest is effectively connected with the permanent establishment or fixed base. In that event, the interest will be taxed as business profits (Article 7) or income from the performance of independent personal services (Article 14).

The proposed treaty defines interest as income from debt claims of every kind, whether or not secured and whether or not carrying a right to participate in profits. In particular, it includes income from government securities and from bonds or debentures, including premiums or prizes attaching to bonds or debentures.

Article 12. Royalties

Under the same system that applies to dividends and interest, the U.S. imposes a 30-percent tax on all U.S. source royalties paid to foreign persons. Royalties are from U.S. sources if they are from property located in the United States, including royalties for the use of or the right to use intangibles in the United States.

The proposed treaty provides for reduction of source basis taxation. Royalties that arise (see royalty source rule discussed below) in one [20] country and are paid to a resident of the other country may be taxed by both countries. However, the withholding tax imposed in the source country may not exceed 10 percent of the gross royalty. The U.S. model calls for an exemption from tax at source.

Royalties are defined for this purpose as payments of any kind received as consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work, including films, radio or television tapes, any patents, trade marks, designs or models, plans, secret formulas or processes, or any other similar rights or property. Royalties also include payments for information concerning industrial, commercial, or scientific experience (e.g., "know-how"). Gains from the alienation of any such rights which are contingent on productivity, use or disposition are also covered by these rules. However, this article does not apply to mineral royalties (which are covered by Article 6) or to payments for the use of tangible personal property (which are covered by Article 7).

Royalties generally "arise" in a country when the payer is that country's government, a political subdivision or a local authority thereof, or a resident of that country. However, where the right or property for which the royalties are paid is used within the United States or Jamaica, the royalties will be deemed to arise in the country in which the right or property is used.

The reduced withholding rates do not apply where the recipient is an enterprise with a permanent establishment in the source country or an individual performing personal services in an independent capacity through a fixed base in the source country, and the royalties are effectively connected with the permanent establishment or fixed base. In that event the royalties will be taxed as business profits (Article 7) or income from the performance of independent personal services (Article 14).

Article 13. Capital Gains

The proposed treaty generally provides that capital gains derived by a resident of one country will be exempt from tax by the source country. This rule is generally the same as U.S. law under which capital gains derived from U.S. sources by foreign investors are generally exempt from U.S. tax.

The exemption does not apply in certain situations, and in those situations the gains may be taxed by both countries (with relief from double taxation provided pursuant to Article 24.) First, gains from the sale or exchange of real property may be taxed in the country where the property is located. Also included in this exception are gains from the sale or exchange of shares of the capital stock of a corporation, or an interest in a partnership, trust or estate, the property of which consists principally of real property located in that country. For this purpose, an interest which an entity holds in a second entity is treated as a real property interest in a country if the second entity's property consists predominantly of real property in that country.

The treatment of the sale of stock of a corporation is consistent with U.S. law. The treatment of a disposition of an interest in a partnership, trust or estate is not. Under U.S. law (Code section [21] 897) the disposition of an interest in a partnership, trust or estate is, to the extent attributable to a U.S. real property interest, considered to be a taxable sale of the real property. The treaty would change this rule by providing that the sale of an interest in such an entity is taxable by the country in which real property is located only if the property of the entity consists principally of real property located in that country. The Committee believes that the treatment accorded dispositions of U.S. real property interests by foreigners should be consistent with the Code. This is particularly true here where the treaty was transmitted to the Senate only four weeks before the real property legislation was passed.

Accordingly, the Committee recommends a reservation that gains from the alienation of an interest in a partnership, trust or estate shall be regarded as income from real property to the extent attributable to real property or to the extent attributable to any interest in shares of a corporation gain from the alienation of which would be treated as income from real property. This treatment of dispositions of interests in partnerships, trusts or estates, is intended to be consistent with U.S. law.

Second, gains on the sale or exchange of property which forms a part of the business property of a permanent establish or a fixed base (including gains on the deposition of the permanent establishment or the fixed base itself) may be taxed in the country where the permanent establishment or fixed base is located. This second exception does not apply to gains from the sale or exchange of ships, aircraft or containers operated by an enterprise of the other country in international traffic; such gains are only taxable by the country of residence.

Third, Jamaica may impose its transfer tax upon the alienation of property in accordance with the Transfer Tax Act as in effect on the date of signature of the treaty. Finally, nothing in the treaty is to prevent a country from levying, according to its domestic law, a tax on gains from the alienation of property derived by an individual who is a resident of the other country and who was a national of the first country at any time during the ten-year period immediately preceding the alienation of the property.

Article 14. Independent Personal Services

Income of a non-resident alien from the performance of personal services in the U.S. is not in the U.S. for at least 90 days, the compensation does not exceed $3,000, and the services are performed as an employee of a foreign person not engaged in a trade or business in the U.S. or they are performed for a foreign permanent establishment of a U.S. person. The United States taxes the income of a nonresident alien at regular rates if the income is effectively connected with the conduct of a trade or business in the U.S. by the individual. (See discussion of U.S. taxation of business profits under Article 7. (Business Profits).) The performance of personal services within the United States can be a trade or business within the United States (sec. 864(b)).

Under the proposed treaty, income from the performance of independent personal services (i.e., services performed as an independent contractor, not as an employee) in one country by a resident of the other country is exempt from tax in the country where the services are [22] performed, unless (1) the person performing the personal service is present in the country where the services are performed for more than 90 days during the taxable year, (2) the individual has a fixed base regularly available to him in that country for the purpose of performing the services, or (3) his net income from services in that country exceeds $5,000 (or its Jamaican dollar equivalent) for the taxable year. If the second requirement (but not the first or third) is met, the source country can only tax that portion of the individual's income which is attributable to the fixed base.

In contrast, the U.S. model treaty would require presence for more than 183 days (rather than 90) under the first requirement. The model also contains no dollar limit on the amount which may be earned free of tax if the first and second requirements are not met.

Article 15. Dependent Personal Services

Under the proposed treaty, income from services performed as an employee in one country (the source country) by a resident of the other country will not be taxable in the source country if four requirements are met: (1) the individual is present in the source country for not more than 183 days during the taxable year; (2) his employer is not a resident of the source country; (3) the compensation is not borne by a permanent establishment or fixed base of the employer in the source country; and (4) the net income from services as an employee in that country for the taxable year does not exceed $5,000 (or its equivalent in Jamaican dollars). The fourth requirement is a departure from the U.S. model treaty, which contains no dollar limitation.

Compensation derived by an employee aboard a ship or aircraft operated by an enterprise of one country in international traffic is exempt from tax by the other country, provided that the compensation is in respect of employment as a member of the regular complement of the ship or aircraft.

This article is modified by the articles covering directors' fees (Article 16), pensions and social security payments (Article 19), and compensation as a government employee (Article 20).

Article 16. Directors' Fees

Directors' fees and similar payments derived by a resident of one country for services rendered in the other country as a member of the board of directors of a company which is a resident of the other country may be taxed in that other country. However, no tax may be imposed by that other country where the amount of the fees, not including reimbursed expenses, do not exceed $400 (or its Jamaican dollar equivalent) per day for each day the resident is present in that other country for the purpose of performing those services.

Article 17. Limitation of Benefits

The proposed treaty, as amended by the proposed protocol, contains a provision which is intended to deny the benefits of the treaty to persons who are not entitled to those benefits by reason of their residence in the United States or Jamaica.

The proposed treaty is intended to limit double taxation caused by the interaction of the tax systems of the United States and Jamaica as they apply to residents of the two countries. At times, however, [23] residents of third countries attempt to use a treaty. Such use is known as treaty shopping, and refers to the situation where a person who is not a resident of either country seeks certain benefits under the income tax treaty between the two countries. Under certain circumstances, the nonresident is able to secure these benefits by establishing a corporation (or other entity) in one of the countries which, as a resident of that country, is entitled to the benefits of the treaty. Additionally, it may be possible for the third country resident to repatriate funds to that third country from the entity under favorable conditions (i.e., it may be possible to reduce or eliminate taxes on the repatriation) either through relaxed tax provisions in the distributing country or by passing the funds through other treaty countries (essentially, continuing to treaty shop), until the funds can be repatriated under favorable terms.

The proposed treaty, as amended by the protocol, contains a provision that is intended to limit the use of the treaty to residents of the two countries. This is accomplished by providing that a business entity (a corporation, partnership, trust, or other business organization) is not entitled to the benefits of the convention unless more than 75 percent of the beneficial interest in that entity is owned by one or more individual residents of the country of which the entity is a resident and the income of the entity is not used in substantial part, directly or indirectly, to meet liabilities to persons who are not residents of Jamaica or the United States, other than any such persons who are individuals subject to tax in the United States or Jamaica on their world-wide income by reason of citizenship. Liabilities include liabilities to pay interest or royalties to a resident of neither the United States nor Jamaica. This provision would, for example, deny the benefits of the reduced U.S. withholding tax rates on dividends, interest or royalties to a Jamaican company that is owned by residents of a third country.

A company that has substantial trading in its stock on a recognized exchange in the United States or Jamaica is presumed to be owned by individual residents of the contracting country in which the company is resident. Accordingly, a Jamaican company traded on the New York Stock Exchange would be considered owned by residents of Jamaica.

An exception is provided so that the denial of treaty benefits do not apply if it is determined that the acquisition, ownership or maintenance of the entity, and the conduct of its operation did not have as a principal purpose obtaining benefits under the proposed treaty. Accordingly, the provision will not apply if it can be shown that there was no treaty shopping motives for forming the company and if it is not in fact operated with the principal purposes of obtaining the treaty benefits. Thus the burden of overcoming the treaty shopping rule is on the taxpayer claiming treaty benefits.

A treaty shopping motive is not present, and accordingly the anti-abuse permission will not apply, to a Jamaican company, which is owned by individual residents of a country other than the United States or Jamaica, if that company does not use income subject to the convention to satisfy liabilities to residents of countries other than the United States and Jamaica, the company is actually engaged in [24] business in Jamaica, and the income for which a treaty benefit is claimed is incidental to or derived in connection with the business operations in Jamaica. It also will not apply if the individual owners of the corporation are residents of countries that have income tax treaties with the United States and under those treaties those individuals would have gotten U.S. tax benefits that are the same or similar to those being claimed by the Jamaican company.

Similar rules are to apply to a U.S. company owned by residents of countries other than Jamaica or the United States when that company derives income and Jamaican tax benefits on that income are claimed under the proposed treaty.

Article 18. Entertainers and Athletes

The proposed treaty contains a set of rules which modify the taxation of income earned by entertainers (such as theater, motion picture, radio or television artistes and musicians) and athletes. The proposed treaty provides that, notwithstanding the other provisions dealing with the taxation of personal services (Articles 14 and 15), each country may tax nonresident entertainers or athletes on the income from their personal activities as such performed in that country if their gross receipts (not including reimbursed expenses or expenses borne on their behalf) exceed $400 or its equivalent in Jamaican dollars per day, or $5,000 or its equivalent in Jamaican dollars for the taxable year concerned. Thus, highly paid entertainers and athletes will be taxable by the country in which they perform, regardless of the period of time spent in that country. However, as in the case of the other provisions dealing with personal services income, this provision does not bar the country of residence or citizenship from also taxing that income. In such a case, double taxation is avoided by the grant of a foreign tax credit (Article 24).

In addition, the proposed treaty provides that where income in respect of personal services performed by an entertainer or athlete is paid not to the entertainer or athlete but rather to another person, that income will be taxable by the country in which the services are performed in any situation where the entertainer or athlete shares directly or indirectly in the profits of the person receiving the income. For this purpose, participation in the profits of the recipient of the income includes the receipt of deferred compensation, bonuses, fees, dividends, partnership distributions, or other distributions. The provision is intended to prevent performers and athletes from avoiding tax in the country in which they perform by routing the compensation for their services through a third person such as a personal holding company.

Article 19. Pensions, Etc.

Under the proposed treaty, pensions derived by a resident of one country may be taxed only by that country unless the services giving rise to the pension were performed in the other country while he was a resident of that other country, in which case that other country may also tax the pension. However, social security payments and other public pensions paid by one country to a resident of the other or a citizen of the United States will be taxable only in the paying country. Annuities beneficially derived by a resident of one country will be taxable only in that country unless the annuity was purchased in the other [25] country while he was a resident of that other country, in which case the annuity may also be taxed in that other country.

Alimony paid by a resident of one country to a resident of the other will be exempt from tax in the recipient's country. Child support paid by a resident of one country to a resident of the other will be exempt from tax in both countries.

Article 20. Government Service

Under the proposed treaty, compensation paid by one country, its political subdivisions or local authorities, to an individual for services performed for the paying governmental entity is exempt from tax by the other country. However, this exemption does not apply if the services are performed in the other country and the individual is a resident and a national of that country. In that situation, the compensation is taxable only by the country where the services are performed. Thus, an individual performing services for a Jamaican governmental entity ordinarily will only be taxable by Jamaica. However, if he performs the services in the United States and is a U.S. citizen and resident, he will be taxable only by the United States.

Pensions paid for services to a governmental entity of either country will generally be taxable only by that country. However, if the recipient is a resident and national of the other country, and was a national of that country at the time the services were rendered, the pension will be taxable only by that other country.

The governmental service rules do not apply in situations where the compensation or pensions are paid in connection with any business carried on by any governmental entity of either country. In such situations, the provisions applicable to the private sector apply; Articles 14 (Independent personal services), 15 (Dependent personal services), 16 (Directors' fees), 18 (Entertainers and athletes) and 19 (Pensions, etc.).

Article 21. Students and Trainees

Under the proposed treaty, a resident of one country who becomes a full-time student in the other country will generally be exempt from tax in the host country on payments from abroad used for maintenance, education, or training.

A resident of one treaty country at the time he becomes temporarily present in the other country as an employee of, or under contract with, a resident of his home country for the primary purpose of acquiring technical, professional, or business experience from a person other than a resident of his home country or other than a person related to such resident, or studying at a university or other recognized educational institution in that other country, is eligible for the trainee exemption. This applies for a period not exceeding 12 consecutive months with respect to his income from personal services in an aggregate amount not in excess of $7,500 or its equivalent in Jamaican dollars.

A student or trainee covered by

these provisions may instead elect under the treaty to be treated for tax purposes as a resident of the host country. The election applies for the entire period that the individual is covered one year for a trainee, and it may not be revoked except with the consent of the competent authority of the host country. The purpose of the election is to permit foreign students and [26] trainees present in the United States to qualify for benefits such as the standard deduction (the zero bracket amount), and for the dependency deductions (if applicable). For example, for U.S. tax purposes nonresident aliens are limited to one personal deduction and they are not permitted to claim the standard deduction or the dependency deduction. By electing to be taxed as U.S. residents, they may claim these deductions but, as a consequence, they are subject to U.S. tax on their worldwide income. This election would generally be advantageous for those foreign students, apprentices, and business trainees who do not have any substantial income from sources the election, he and his spouse may, also elect for the spouse to be treated as a U.S. resident pursuant to section 6013(g) of the Code.

Article 22. Teachers and Researchers

A resident of one country who visits the other for the purpose of teaching or engaging in research at a university, college, or other recognized educational institution is eligible for exemption from tax by the host country on compensation from that teaching or research. The exemption does not apply, however, if the visit at its inception is expected to last more than two years, and the exemption is limited to the initial two years of the visit in any event. Also, the exemption applies to income from research only if the research is undertaken by the individual in the public interest and not primarily for the benefit of some other private person or persons. The exemption for income from teaching and research may be used by an individual only once in his lifetime.

Article 23. Other Income

As a general rule, any item of income, regardless of its source, which is derived by a resident of either country and which is not dealt with in one of the other articles of the treaty will be taxable only by the country of residence. However, such an item of income which is received by a resident of one country who is a citizen of the other may be taxed by both countries (Articles 1 (Personal scope)), subject to a foreign tax credit for taxes paid to the other if the other country is the country of source (Article 24 (Relief from double taxation)).

However, this general rule does not apply if the recipient of the income is a resident of one country and carries on business in the other country through a permanent establishment or a fixed base, and the right or property in respect of which the income is paid is effectively connected with the permanent establishment or fixed base. In such a case the provisions of Article 7 (Business profits), Article 14 (Independent personal services), or Article 18 (Articles and Athletes), as the case may be, will apply.

Moreover, notwithstanding either of these rules, if a resident of one country receives income which arises in the other, the income may be taxed by that other country.

Article 24. Relief from Double Taxation

In general

One of the principal purposes of entering into an income tax treaty is to limit double taxation of income earned by a resident of one of the countries that may be taxed by the other country. The United States seeks to unilaterally mitigate double taxation by allow [27] ing U.S. taxpayers to credit the foreign income taxes that they pay against the U.S. tax imposed on their foreign source income. A fundamental premise of the foreign tax credit is that it may not offset the U.S. tax on U.S. source income. Therefore, the foreign tax credit provisions contain a limitation that insures that the foreign tax credit only offset the U.S. tax on foreign source income. This limitation is computed on world-wide consolidated basis. Hence, all income taxes paid to all foreign countries are combined to offset U.S. taxes on all foreign income.

A U.S. corporation that owns 10 percent or more of the stock of a foreign corporation may credit foreign taxes paid or deemed paid by that foreign corporation on earnings that are received as dividends (deemed paid credit). These deemed paid taxes are included in the U.S. shareholder's total foreign taxes paid for the year the dividend is received and go into the general pool of taxes to be credit.

Separate limitations on the foreign tax credit are provided for certain interest, DISC dividends, and oil income.

Unilateral efforts to limit double taxation are imperfect. Because of differences in rules as to when a person may be taxed on business income, a business may be taxed by two countries as if it were engaged in business in both countries. Also, a corporation or individual may be treated as a resident of more than one country and be taxed on a worldwide basis by both.

United States

Under the proposed treaty, the United States agrees to provide its citizens and residents with a foreign tax credit against their U.S. income tax for the appropriate amount of taxes paid to Jamaica. The credit allowed for U.S. tax purposes is in accordance with the provisions and subject to the limitations of U.S. law applicable to the year in question. Under present law, the United States only allows a credit for foreign income taxes (sec. 901 of the Internal Revenue Code), or foreign taxes imposed in lieu of income taxes (Code sec. 903), and the credit is limited to the amount of the pre-credit U.S. tax which is attributable to foreign source income (Code secs. 904 and 907).

The proposed treaty also provides that a deemed-paid foreign tax credit will be made available to a U.S. company with respect to dividends from a Jamaican company in which it owns, directly or indirectly, at least 10 percent of the voting power. In this case, a credit will be allowed for the Jamaican tax paid by the Jamaican company on the profits out of which the dividend is paid. A deemed-paid foreign tax credit satisfying the treaty requirements is presently provided under the Internal Revenue Code (sec. 902).

The treaty provides that the Jamaican taxes currently covered by the treaty, and similar subsequently-

READEX FICHE

enacted taxes, will be treated as "income taxes" eligible, within the statutory limits, for the credit. In the Exchange of Notes accompanying the proposed treaty, the United States agrees that if Jamaica imposes a tax on extraction and refining of bauxite which is in lieu of the company profits tax, that new tax would be covered by the treaty (and eligible for the foreign tax credit), but only if it met the requirements of section 903 of the Internal Revenue Code.

[28] *Jamaica*

The proposed treaty similarly provides that, in accordance with and subject to the limitations of Jamaican law for the taxable year, Jamaica will allow its citizens and residents a credit against their Jamaican tax for the appropriate amount of taxes paid to the United States. Jamaica also agrees to provide an indirect credit in the case of a dividend paid by a U.S. company in which a Jamaican company has at least 10 percent of the voting power. The amount of the credit is based on the U.S. tax on the profits out of which the dividend is paid.

For the purpose of applying both the U.S. and Jamaican credits under the treaty, the treaty prescribes rules for determining the source of income.

Article 25. Nondiscrimination

The proposed treaty contained a comprehensive nondiscrimination provision relating to all taxes of every kind imposed at the national, state, or local level. It is similar to provisions which have been embodied in other recent U.S. income tax treaties.

Under this provision, neither country can discriminate by imposing more burdensome taxes (or other requirements connected with taxes) on citizens of the other country than it imposes on its own citizens who are in the same circumstances. This provision does not, however, require either country to grant to residents of the other country the personal allowances, reliefs, or credits for taxation purposes on account of personal status or family responsibilities which it grants to its own residents.

Similarly, neither country may tax a permanent establishment of an enterprise of the other country less favorably than it taxes its own enterprises carrying on the same activities. In determining the taxable income of an enterprise of either country, both countries are required to allow the enterprise to deduct interest, royalties, and other disbursements paid by the enterprise to residents of the other country under the same conditions that they allow deductions for such amounts paid to residents of the same country as the enterprise. The nondiscrimination provision also applies to corporations of one country which are owned by residents of the other country.

However, nothing in the nondiscrimination article is to prevent Jamaica from charging a higher rate of income tax under section 48(5) of the Income Tax Act of Jamaica on a life insurance company which is a resident of the United States than on a regionalized life assurance company. Also, in the Exchange of Notes accompanying the proposed treaty, it is observed that Jamaica requested that the nondiscrimination provisions not prevent Jamaica from imposing special taxes in pursuance of its economic development program, even if these taxes might otherwise violate those provisions. The United States explained that it could not agree to such a provision before having the opportunity to examine the specific aspects of such legislation. The United States delegation also believed that it would be inappropriate to grant to the competent authorities the power to expand in this way the scope of the treaty by administrative action. However, the United States agreed that if at some time in the future Jamaica [29] should enact legislation which would contravene the nondiscrimination provisions, the United States would be prepared to reopen discussions with Jamaica to determine whether it would be appropriate to except the legislation from the scope of those provisions.

The provision is not intended to restrict the right of the United States to tax foreign corporations on their dispositions of a U.S. real property interest because of effect of the provisions imposing the tax is not discriminatory. Nor is the provision intended to permit a foreign corporation to claim the benefit of U.S. statutory provisions intended to eliminate U.S. double taxation, such as the dividends received exclusion provided by section 243.

The proposed treaty, as amended by the proposed protocol, contains a provision that permits U.S. taxpayers a deduction for expenses of attending a convention in Jamaica to the extent that the expenses would be deductible if the convention were held in the U.S. Under U.S. law (Sec. 274(h)) a U.S. taxpayer is not permitted to deduct expenses of attending a convention outside of the United States, Canada, or Mexico unless the taxpayer can establish that the locality and the purpose, activities or residences of the active members of the sponsoring organization, justified the foreign location. Initially, the provision denied deductions for conventions outside the United States. However, in 1980 the deduction was extended to conventions held in Canada and Mexico.

The proposed treaty, as amended by the proposed protocol, would permit a deduction for attendance at a convention held in Jamaica provided that the normal U.S. rules (such as business purpose) for attending conventions in the United States are met. The provision covers only the expenses concurred for meals, lodging, and the personal sustenance and comfort of the traveler, the registration fees, including fees for the cost of materials, and the ground and air transportation to and from the convention site. These expenses are allowed to the extent otherwise allowable under U.S. law. A similar provision is included in the proposed Canadian treaty.

Article 26. Mutual Agreement Procedure

The proposed treaty contains the standard mutual agreement provision which authorizes the competent authority of the United States and Jamaica to consult together to attempt to alleviate individual cases of double taxation or cases of taxation not in accordance with the proposed treaty.

Under the proposed article a resident or citizen of one country who considers that the action of the countries or either of them will cause him to pay a tax not in accordance with the treaty may present his case to the competent authority of the country of which he is a resident or citizen. A resident who has a permanent establishment or fixed base in the other country may present his case to either country. The competent authority then makes a determination as to whether or not the claim has merit. If it is determined that the claim does have merit, and if the competent authority cannot unilaterally solve the problem, that authority endeavors to come to an agreement with the competent authority of the other country to limit the taxation which is not in accordance with the provisions of the treaty.

[30] Adjustments are to be made even if the statute of limitations has run. For Jamaica, however, the competent authority must be notified of a possible adjustment before the statutory period runs.

A second provision directs the competent authorities to resolve any difficulties or doubts arising as to the interpretation of application of the proposed treaty. Specifically, they are authorized to agree as to the attribution of income deductions or credits and the readjustment of taxes, the determination as to source of income, the characterization of items of income, and to the common meaning of terms. Under this authority, the Internal Revenue Service from time to time issues rulings defining terms in a treaty.

The purposed treaty contains a provision, not found in most existing treaties, that permits the competent authorities to agree to increase dollar amounts reflected in the treaty to reflect monetary or economic developments. The monetary amounts are generally the threshold amount which a resident of one country may earn from services performed in the other country before the other country can tax the resident. The adjustment will be made when the competent authorities deem it appropriate. If made, it is intended that any increase in dollar amount will generally reflect changes in the Consumer Price Index (CPI) for all urban consumers published by the Department of Labor and will be computed by taking into account the percentage by which the CPI for the calendar year preceding the year in which the adjustment is made exceeds the CPI for the calendar year in which the treaty enters into force. However, the adjustment does not have to precisely reflect changes in the CPI. It may, for example, take into account changes in the cost of living in Jamaica. It does not have to be made annually.

The treaty also contains a provision that authorizes the competent authorities to consult together for the elimination of double taxation in cases not provided for in the treaty. This provision is intended to permit the competent authorities to perfect and carry out the general purposes of the treaty in particular cases in a manner that is consistent with the expressed general purposes of the treaty. It permits the competent authorities to deal with cases that are within the spirit and sense of the provisions but which are not specifically covered. Thus, the authority delegated should be construed as is analogous to a grant of broad regulatory authority to deal with problems that may arise as distinguished from a grant of legislative authority. It might, for example, be compared to the regulatory authority granted to the Secretary of the Treasury under section 482. The provision is not intended to authorize the competent authorities to deal with problems of major policy significance that normally would be the subject of negotiations if they had been focused on during that process.

For example, this provision would not authorize the competent authorities to agree to allow a U.S. foreign-tax credit for a tax imposed by the other country where that tax is not otherwise a covered tax or an identical or substantially similar tax imposed after the date of signature of the treaty.

The treaty authorizes the competent authorities to communicate with each other directly for purposes of reaching an agreement in the sense of the mutual agreement provision. This would include meeting to- [31] gether for an oral exchange of opinions. These provisions make clear that it is not necessary to go through normal diplomatic channels in order to discuss problems arising in the application of the treaty and also removes any doubt as to restrictions that might otherwise arise by reason of the confidentiality rules of the United States or Jamaica.

Article 27. Exchange of Information and Administrative Assistance

This article forms the basis for cooperation between the two countries to attempt to deal with avoidance or evasion of their respective taxes and to enable them to obtain information so that they can properly administer the treaty. The proposed treaty provides for the exchange of information which is necessary to carry out the provisions of the proposed treaty or for the prevention of fraud or for the administration of statutory provisions concerning taxes to which the convention applies. However, the exchange of information is not limited to taxes covered by the proposed treaty.

The information exchanged may relate to tax compliance generally and not merely to avoidance or evasion of tax.

Information exchanged is to be treated as secret in the same manner as information obtained under the domestic laws of the receiving country, except that it may be disclosed to persons involved in the assessment, collection, enforcement, or prosecution concerning the taxes to which the treaty applies. The information may be used for such purposes only. The Committee understands that there is a question as to whether, under the language of the treaty, the Congress, in the exercise of its oversight responsibilities, could obtain the information. The Committee believes that such access is permitted, and is recommending that the treaty be approved subject to an understanding that such access is permitted.

The proposed treaty contains narrow limitations on the obligations of the countries to supply requested information. A country is not required to carry out administrative measures contrary to its law or administrative practice, to supply particulars not obtainable under its laws or in the normal course of administration, or to supply information that would disclose a trade secret or the disclosure of which would be contrary to public policy.

The proposed treaty provides that a country receiving a request will endeavor to obtain the information requested the same way as if its own taxation was involved. The country would be obligated to obtain the information even if it does not, at the time, need the information. A requested country will use its subpoena or summons powers and any other powers that it has under its own laws to collect information requested by the other country, even though it itself does not need that information for its own purposes. The requested competent authority will attempt to provide the information requested in the form requested. Specifically, the competent authority will attempt to provide depositions of witnesses and authenticated copies of unedited original documents (including books, papers, statements, records, accounts or writings) to the extent that they can be obtained under the laws and practices of the requested country in the enforcement of its own tax laws.

[32] The countries will also collect taxes for the other country, but only to the extent necessary to insure that benefits of the treaty are not going to persons not entitled to those benefits. The provisions does not require a country to collect any other taxes of the other country. The collection activities are to be carried out only in accordance with the administrative measures used by the collecting country to collect its own tax, and not in a manner contrary to its sovereignty, security, or public policy.

It is understood that in obtaining information a requested country will use the powers and procedures that it has available to it under its laws, even if the requested country does not have similar powers and procedures for obtaining the information. Thus, it is not intended that provision be strictly reciprocal. For example, once the U.S. Internal Revenue Service has referred a case to the Justice Department for possible criminal prosecution, the United States investigators can no longer use an administrative summons to obtain information. If, however, Jamaica could still use administrative process to obtain requested information, it would be expected to do so even though the U.S. cannot. The U.S. could not, however, tell Jamaica which of its procedures to use.

Article 28. Diplomatic Agents and Consular Officials

The proposed treaty contains the rule found in other U.S. tax treaties that its provisions are not to affect the taxation privileges of diplomatic and consular officials under the general rules of international law or the provisions of special agreements.

Article 29. Entry into Force

The proposed treaty will enter into force upon the exchange of instruments of ratification. It will take effect with respect to income of taxable years beginning on or after the first day of January of the year after the year in which it enters into force and with respect to taxes payable at the course on or after the first day of the second month after the month in which it enters into force. As the provisions of the proposed treaty come into effect, the corresponding provisions of the extension to Jamaica of the 1945 treaty between the United States and the United Kingdom will terminate.

Article 30. Termination

The proposed treaty will continue in force indefinitely, but either country may terminate it at any time after 5 years from its entry into force by giving at least 6 months' prior notice through diplomatic channels. Such a termination will be effective with respect to income of taxable years beginning (or, in the case of withholding taxes, amounts paid or credited) on or after January 1 next following the expiration of the 6-month period.

Exchange of Notes

In notes exchanged at the time of the signing of the treaty, the United States offered assurances to Jamaica that, when circumstances permitted, the United States would be prepared to resume discussions with a view to incorporating provisions into the treaty, con- [33] sistent with U.S. income tax policies regarding other developing countries, which will minimize the interference of the United States tax system with incentives offered by the Government of Jamaica.

The Notes also dealt with issues under the nondiscrimination provisions (discussed previously under Article 25 (Nondiscrimination) and the status of a possible Jamaican tax on bauxite extraction and refining (discussed previously under Article 2 (Taxes covered) and Article 24 (Relief from double taxation)).

Protocol

Explanation

After the proposed treaty was signed, a proposed protocol modifying the proposed treaty as signed. Also, notes were exchanged in connection with the signing of the proposed protocol. The proposed protocol adds a new provision which would permit U.S. citizens to deduct expenses of attending business conventions in Jamaica. This provision is discussed in more detail under the discussion of Article 25 (Nondiscrimination). Also, the proposed protocol contains two provisions intended to limit potential abuse of the convention by denying treaty benefits in situations where those benefits were not intended. First, it makes it clear that the United States can continue to tax former citizens who reside in Jamaica under the Internal Revenue Code. Second, it contains a far-reaching provision denying treaty benefits to residents of third countries who establish a corporation or other entities in either Jamaica or the United States for the principal purpose of obtaining treaty benefits from the other countries. This provision is discussed in more detail in discussion of Article 17.

The protocol will enter into force upon the exchange of instruments of ratification and will become effective in accordance with the provisions of the proposed treaty.

Exchange of Notes Under the Protocol

The notes exchanged at the time of the signing of the protocol state that the antitreaty shopping provision contained in the protocol is not intended to impede the bona fide investment in Jamaica by residents of third countries. Also, the notes commit the two countries to enter into negotiation of new treaties on extradition and mutual assistance on criminal matters.

IX. TEXT OF THE RESOLUTION OF RATIFICATION

Resolved (two-thirds of the Senators present concurring therein), That the Senate advise and consent to the ratification of the Convention between the Government of the United States of America and the Government of Jamaica for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (the Convention), together with a related exchange of notes, signed at Kingston on May 21, 1980, and the Protocol Amending the 1980 Convention, together with a related exchange of notes, signed at Kingston on July 17, 1981, subject to the following:

(1) reservation that, notwithstanding the provisions of paragraph (5) of Article 13 of the convention (which relates to the [34] taxation of gains from the alienation of shares of a corporation or of an interest in a partnership, estate, or trust, the property of which consists, directly or indirectly, principally of real property situated in one of the countries), gain derived by a resident of a Contracting State from the alienation or other disposition of an interest in a corporation, or an interest in a partnership, trust, or estate, which has an interest in real property located in the other Contracting State, or the assets of which are considered under the domestic law of that other Contracting State to consist, in whole or in part, of real property, or an interest therein, in that other State, may be taxed by that other State to the extent provided for by its domestic law. In addition, gain derived by a corporation which is a resident of a Contracting State upon the distribution including a distribution in liquidation or otherwise) of an interest in real property in other Contracting State as determined under the domestic law of the other Contracting State) may be taxed by that other Contracting State to the extent provided for by its domestic law.

(2) understanding that, appropriate Congressional committees and the General Accounting Office shall be afforded access to the information exchanged under this treaty where such access is necessary to carry out their oversight responsibilities, subject only to the limitations and procedures of the Internal Revenue Code.

TECHNICAL EXPLANATION OF THE CONVENTION [1] BETWEEN THE UNITED STATES OF AMERICA AND JAMAICA FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME SIGNED AT JAMAICA ON MAY 21, 1980, AS AMENDED BY THE PROTOCOL SIGNED AT JAMAICA ON JULY 17, 1981 [2]

INTRODUCTION

In this technical explanation of the Convention between the United States and Jamaica signed on May 21, 1980, as amended by the Protocol signed on July 17, 1981 ("the Convention"), references are made to the U.S. Model Income Tax Convention of 1977 (the "U.S. Model") and to the extension in 1959 to Jamaica of the 1945 Income Tax Convention between the United States and the United Kingdom, as amended by Protocols of June 6, 1946, May 25, 1954 and August 16, 1957 ("the 1959 Convention"). These references are intended to put various provisions of the Convention into context. The technical explanation does not, however, provide a complete comparison between the Convention and either the U.S. Model or the 1959 Convention. Moreover, neither the Convention nor the technical explanation is intended to have implications for the interpretation of the 1959 Convention.

The technical explanation is an official guide to the Convention. It reflects policies behind particular Convention provisions, as well as understandings reached with respect to the interpretation and application of the Convention.

Article 1. PERSONAL SCOPE

Article 1 identifies the persons who come within the scope of the Convention. Paragraph 1 provides that, in general, the Convention applies to persons who are residents of one or both of the Contracting States. The term "resident" is defined in Article 4 (Residence). The Convention may also apply to residents of third States. For example, paragraph 6 of Article 10 (Dividends) covers certain dividends derived by residents of third States and Article 27 (Exchange of Information) may apply to an exchange of information concerning residents of third States.

Paragraph 2 provides that the Convention shall not restrict any exclusion, exemption, deduction, credit or other allowance provided by the laws of either Contracting State or by any other agreement between the Contracting States. Thus, if a deduction would be allowed under the Internal Revenue Code of 1954 ("the Code") for an item in computing the taxable income of a Jamaican resident, such deduction is generally available to such person in computing taxable income under the Convention. Paragraph 2 does not, however, authorize a taxpayer to make inconsistent choices between rules of the Code and rules of the Convention. Thus, if a taxpayer claims the benefits of a provision of the Convention, he must use the rules of the Convention relevant to such benefit, and must use such rules consistently. In no event, however, are the rules of the Convention to increase U.S. tax liability from what that liability would be if there were no convention.

---

[1] It is the practice of the Treasury Department to prepare for the use of the Senate and other interested persons a Technical Explanation of the tax conventions and protocols, which are submitted to the Senate for its advice and consent to ratification.

An Income Tax Convention with Jamaica and accompanying Exchange of Notes were signed May 21, 1980, and submitted by the President to the Senate on August 4, 1980. The Amending Protocol to the Convention and accompanying Exchange of Notes were signed July 17, 1981 and submitted by the President to the Senate on September 8, 1981. On September 24, 1981, the Senate Committee on Foreign Relations held hearings and the Technical Explanation was presented. The Senate voted its advice and consent on December 16, 1981, and instruments of ratification were exchanged on December 29, 1981.

[2] Page 257; pertinent excerpts from Senate Executive Report No. 97-40, page 274; Senate Executive O is not published.

Paragraph 3 contains the traditional "saving clause" under which each Contracting State reserves the right to tax its residents, as determined under Article 4, as if the Convention had not come into effect. In the case of the United States, the "saving clause" applies to former citizens as well as to current citizens. Thus, a former U.S. citizen whose loss of citizenship had as one of its principal purposes the avoidance of income tax will continue to be subject to U.S. income tax, in accordance with the provisions of section 877 of the Code, but only for a period of ten years following the loss of citizenship. This point is clarified by Article I of the Protocol.

Paragraph 4 sets forth certain exceptions to the saving clause. These exceptions are, in general, necessary to assure that provisions of the Convention intended to reduce a resident's tax liability to his country of residence fulfill their intended objective. Subparagraph (a) provides that the saving clause does not affect the benefits provided under paragraphs 1(b) and 4 of Article 19 (Pensions, etc.) and Articles 24 (Relief from Double Taxation), 25 (Non-Discrimination) and 26 (Mutual Agreement Procedure). Thus, notwithstanding the saving clause, the benefits of these Articles are available to residents and citizens of a Contracting State, as provided in the Articles.

Subparagraph (b) of paragraph 4 provides a second category of exceptions to the saving clause for persons who are residents of a Contracting State but are not citizens of that State and do not have immigrant status in that State. This second category of exceptions includes benefits conferred under Articles 20 (Government Service), 21 (Students and Trainees), 22 (Teachers and Researchers) and 28 (Diplomatic Agents and Consular Officers).

Article 2. TAXES COVERED

Paragraph 1 states that the Convention applies to taxes on income imposed by a Contracting State. Paragraph 1 is not intended either to broaden or limit paragraph 2, which provides that the Convention shall apply to the following Jamaican taxes: the Jamaican income tax, company profits tax and transfer tax. Thus, paragraph 2 does not encompass the Jamaica bauxite production levy. It is not intended that the omission of the production levy from paragraph 2 should have any implications for the U.S. tax treatment of such levy.

Paragraph 2 also designates the existing United States taxes to which the Convention shall apply. These taxes are the Federal income taxes imposed by the Code, but excluding the accumulated earnings tax (Code section 531), except as provided in paragraph 5 of Article 10 (Dividends), and the personal holding company tax (Code section 541). Thus, this paragraph and paragraph 5 of Article 10 restrict the application of the accumulated earnings tax in the case of certain Jamaican tax incentive companies and certain companies controlled by residents of Jamaica. See the discussion of paragraph 5 of Article 10 below. Paragraph 2 does not cover the excise tax on insurance premiums paid to foreign insurers, the excise tax with respect to private foundations, or U.S. social security taxes.

Except for Article 25 (Non-Discrimination), the Convention does not apply to taxes on capital, and it applies to taxes imposed only at the national level. Capital taxes are not generally covered by this Convention because neither State currently imposes capital taxes.

Paragraph 3 provides that the Convention shall also apply to any taxes imposed subsequent to May 21, 1980, which are identical or substantially similar to the taxes existing on that date and covered by the Convention. The competent authorities agree to notify each other of any significant changes in their respective tax laws and of any official published material relating to the application of the Convention including this technical explanation.

Paragraph 3 also provides that the Convention shall apply to a tax imposed by Jamaica in lieu of the Jamaican income tax or company profits tax covered by paragraph 2(b). As explained in the Exchange of Notes signed on May 21, 1980, such a tax must meet the requirements of Code section 903 to be covered by the Convention.

Paragraph 4 provides that the Convention applies to taxes of all kinds imposed at all levels of government for the purposes of Article 25 and to all national taxes for the purposes of Article 27 (Exchange of Information and Administrative Assistance).

Article 3. GENERAL DEFINITIONS

Paragraph 1 defines the principal terms used in the Convention. Unless the context otherwise requires, a term defined in this paragraph has a uniform meaning throughout the Convention. A number of important terms are, however, defined in other Articles. For example, the terms "resident" and "permanent establishment" are defined in Articles 4 (Residence) and 5 (Permanent Establishment), respectively, and the terms "dividends," "interest," and "royalties" are defined in Articles 10 (Dividends), 11 (Interest) and 12 (Royalties), respectively.

Paragraph 1(a) of this Article defines the term "person" to include an individual, a partnership, a company, an estate, a trust and any other body of persons. The term "company" means any body corporate or any other entity which is treated as a body corporate for tax purposes.

The terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean an enterprise or undertaking carried on by a resident, as defined by Article 4, of the United States or Jamaica, as the context requires.

The term "international traffic" means any transport by a ship or aircraft except where such transport is solely between places in the other Contracting State. Thus, for example, coastal shipping along the Atlantic coast of the United States is not international traffic. However, if a ship operated by a resident of Jamaica transports goods from Canada to the United States, leaving some of the goods in New York and the remainder in Norfolk, the entire transport would be international traffic. The definition of international traffic is relevant for purposes of Article 8 (Shipping and Air Transport).

The term "competent authority" is defined in paragraph 1(e) to mean, in the case of the United States, the Secretary of the Treasury or his delegate. The Secretary has delegated the general authority to act as competent authority to the Commissioner of Internal Revenue Service, who has redelegated such authority to the Assistant Commissioner (Compliance), with the concurrence, in certain cases, of the Assistant Commissioner (Technical). The Assistant Commissioner (Compliance) has redelegated authority to the Director of International Operations to administer programs for routine and specific exchanges of information and mutual assistance in collection and to the Director, Examination Division, to administer programs for simultaneous and industrial exchanges of information.

The term "United States" is defined to mean the United States of America and, when used in a geographical sense, includes the States and the District of Columbia, the U.S. territorial water and any area outside the States and the District of Columbia which, in accordance with international law and the laws of the United States, is an area within which the rights of the United States with respect to the natural resources of the seabed and subsoil may be exercised.

The term "Jamaica" means the island of Jamaica, the Morant Cays the Pedro Cays and their Dependencies. When used in a geographical sense "Jamaica" includes the territorial waters of Jamaica and any area outside such territorial waters which in accordance with international law and the laws of Jamaica is an area with in which the rights of Jamaica with respect to the natural resources of the seabed and subsoil may be exercised.

The term "Contracting State" is defined to mean the United States or Jamaica, as the context requires.

A "national" of the United States is defined as a citizen of the United States as well as any company, association or other entity deriving its status as such from the laws of the United States, or of any political subdivision. A "national" of Jamaica is defined as a citizen of Jamaica, and any company, association, or other entity, such as a trust, deriving its status as such from the laws of Jamaica. The term "national" is used in Articles 20 (Government Service), 25 (Non-Discrimination) and 26 (Mutual Agreement Procedure).

Paragraph 2 provides that in the case of a term not defined in the Convention the domestic tax law of the Contracting State applying to the Convention shall control, unless the context in which the term is used requires a definition independent of domestic tax law or the competent authorities reach agreement on a meaning pursuant to Article 26 (Mutual Agreement Procedure). The term "context" refers to the purpose and background of the provisions in which the term appears.

Pursuant to the provisions of Article 26, the competent authorities of the Contracting States may resolve by mutual agreement any difficulties or doubts as to the interpretation or application of the Convention. An agreement by the competent authorities with respect to the meaning of a term used in the Convention would supercede conflicting meanings in the domestic laws of the Contracting States.

Article 4. RESIDENCE

This Article sets forth rules for determining the residence of individuals, companies, and other persons for purposes of the Convention. Article 4 is important because, except as otherwise provided, only a resident of a Contracting State may claim benefits under the Convention. And, a determination of residence under this Article applies for all other provisions of the Convention. In general, the determination of residence begins with a person's liability to tax as a resident under the respective taxation laws of the Contracting States. Thus, a person who, under those laws, is a resident of one Contracting State need look no further. However, the Convention definition is also designed to assign residence to one State or the other for purposes of the Convention in circumstances where each of the States believes a person to be a resident. The Convention definition is, of course, exclusively for purposes of the Convention.

The term "resident of Jamaica" is defined as a company (as defined in paragraph 1(b) of Article 3 (General Definitions) whose business is managed and controlled in Jamaica and any other person (except a company) resident in Jamaica for purposes of its tax.

Similarly, the term "resident of the United States" is defined as a person (except a company) resident in the United States for purposes of its tax. This includes a resident alien individual, who is subject to tax by the United States on his worldwide income, or an alien present in the United States who makes an election under Code section 6013(g) or (h), as well as a resident U.S. citizen. The term also includes a company which is created or organized under the laws of the United States or a political subdivision thereof.

An individual is not automatically a resident of the United States or Jamaica for the purposes of this Convention if he is a citizen of either State To be a resident of a Contracting State for purposes of the Convention, he must be subject to tax in that State on account of his residence therein. Thus, an individual will be considered to be a U.S. resident if, without regard to his citizenship, he would be taxable by the United States on his worldwide income as a resident. Residence for this purpose is to be determined in accordance with the principles of Treasury regulations under section 871 of the Internal Revenue Code.

Paragraph 1 of this Article also provides that a partnership, estate, or trust is a resident of a Contracting State only to the extent that the income derived by such person is subject to tax by such Contracting State as the income of a resident. For example, under United States law, a partnership is never, and an estate or trust is often not, taxed as such. Thus, under the Convention, a partnership, estate, or trust will be treated as a resident of the United States only to the extent that income derived by such partnership, estate, or trust is subject to tax by the United States as the income of a U.S. resident. Similarly, if a resident of Jamaica and a resident of a third State form a partnership, and the partnership derives dividends from the United States, the limitation of U.S. tax under the provisions of Article 10 (Dividends) applies only to the dividends of the partner resident of Jamaica. However, the fact that a charitable organization or pension fund is generally exempt from tax by the Contracting State in which it is organized is not to be construed to deny such entity's status as a resident of that State under the Convention.

Paragraph 2 provides a series of tie-breaking rules for assigning residence to an individual who under paragraph 1 is a resident of both Contracting States. The first test depends upon where the individual has a permanent home available. If this test is inconclusive because the individual has a permanent home in both States or in neither of them, he is considered a resident of the State which is the center of his vital interests; i.e., the State with which his personal and economic relations are closer. If such a center cannot be determined, residence is where the individual has an habitual abode. If he has an habitual abode in both States or in neither of them, he is deemed to be a resident of the State of which he is a national. Should the individual be a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question of residence by mutual agreement under the authority of Article 26 (Mutual Agreement Procedure).

Paragraph 3 provides that a company which under paragraph 1 is a resident of both Contracting States (i.e., it is incorporated in the United States and has its place of effective management in Jamaica) shall be considered to be outside the scope of the Convention except for purposes of paragraph 2 of Article 10 (Dividends) in the case of dividends paid by such a company, Article 25 (Non-Discrimination), Article 26 (Mutual Agreement Procedure), Article 27 (Exchange of Information and Administrative Assistance) and Article 29 (Entry into Force). Thus, such a corporation is generally taxable as a resident by both Contracting States pursuant to their respective taxation laws. This paragraph differs from the U.S. Model Income Tax Convention which provides that a company resident in both contracting states is considered to be a resident of the contracting state under whose laws it was organized.

Paragraph 4 provides that if under paragraph 1 a person, other than an individual or a company, is a resident of both Contracting States, the competent authorities shall endeavor to agree on a single residence for such person and on how the Convention applies to such person. This provision applies to persons such as partnerships, trusts and estates.

Paragraph 5 provides that where income otherwise eligible for relief from source basis tax under the Convention (e.g., under Articles 7 (Business Profits), 8 (Shipping and Air Transport), 10 (Dividends), 11 (Interest) and 12 (Royalties)), is denied such source basis benefits if the income is taxable to a person in the other Contracting State only if, and to the extent, it is remitted to or received by that person. For example, in certain cases individuals who are residents of Jamaica are not taxable by Jamaica on foreign source investment income, unless it is remitted to or received by them in Jamaica. If such income were received outside of Jamaica, or accumulated by the payer, the Jamaican resident would not be subject to Jamaican tax on that income. Thus, paragraph 5 provides that the reductions in rates or exemptions from U.S. tax otherwise provided to such a person by the Convention do not apply to the extent such items of income are not remitted to or received by such person in the calendar year the income accrues. Otherwise, the United States would be foregoing tax where double taxation does not in fact occur. Note that paragraph 5 does not deny source basis tax benefits if the income is remitted to or received in the other Contracting State by the end of the calendar year following the calendar year in which the income accrued.

Article 5. PERMANENT ESTABLISHMENT

This Article defines the term "permanent establishment," which is relevant particularly to the taxation of business profits under Article 7 (Business Profits). Paragraph 1 defines the term "permanent establishment" as a fixed place of business through which the business of an enterprise is wholly or partly carried on. Paragraph 2 provides an illustrative list of fixed places of business which constitute a permanent establishment. The list includes: a place of management; a branch; an office; a factory; a workshop; a store or premises used as a sales outlet; a warehouse, in relation to a person providing storage facilities for others; a mine, an oil or gas well, a quarry or any other place of extraction of natural resources. The term "place of management" is used in the OECD Model Income Tax Convention. Since a place of management would in most cases require an office, which is specifically listed in paragraph 2, the insertion of "place of management" will generally not cause a fixed place of business to be a permanent establishment if it would not otherwise be a permanent establishment. The subparagraph (f) reference to a premises used as a "sales outlet" does not mean that premises used by an enterprise for the mere delivery of goods is a permanent establishment; additional significant activity by the enterprise at the premises, such as the negotiation of sales and delivery of goods, is necessary for the premises to constitute a "sales outlet" and a permanent establishment of the enterprise.

Paragraph 2(i) provides that a building site or construction, assembly, installation, or dredging project, or a drilling rig or ship used for the exploration of natural resources within a Contracting State constitutes a permanent establishment, but only if the project or activity continues within that State for one or more periods totaling 183 days in a 12 month period. For a permanent establishment to exist in any one year, however, the site, project, or activity must continue for at least 30 days in that year. A series of contracts or projects which are interdependent both commercially and geographically is to be treated as a single project for the purpose of applying the 183 day test.

Paragraph 2(j) provides that the furnishing of services, including consultancy, management, technical, and supervisory services within a Contracting State by an enterprise through employees or other personnel constitutes a permanent establishment but only if: the activities continue within that State for a period or periods aggregating more than 90 days in any 12 month period (and for 30 days or more in the taxable year); or, the services are performed within that State for a related enterprise. Thus, if a calendar year taxpayer provides consulting services to several unrelated companies in Jamaica for 25 days during December of year 1 and for 70 days during January-November of year 2, the taxpayer will be considered, under paragraph 2(j), to have a permanent establishment in Jamaica in year 2.

Paragraph 2(k) provides that the maintenance of substantial equipment or machinery within a Contracting State constitutes a permanent establishment, but only if such equipment or machinery is maintained within that State for a period exceeding 120 consecutive days (and for 30 days or more in the taxable year).

Paragraph 3 overrides paragraphs 1 and 2 to provide that a fixed place of business may be used for one or more of the following activities and not be a permanent establishment:

(a) the use of facilities solely for the purpose of storage, display, or delivery of goods or merchandise belonging to the enterprise, other than goods or merchandise held for sale by such enterprise in a store or premises used as a sales outlet;

(b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery, other than goods or merchandise held for sale by such enterprise in a store or premises used as a sales outlet;

(c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise; ,

(d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise;

(e) the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research or for similar activities which have a preparatory or auxiliary character, for the enterprise.

It should be noted that the phrase "other than goods or merchandise held for sale by such enterprise in a store or premises used as a sales outlet" in paragraph (3)(a) and (b) narrows somewhat these exceptions to the definition of permanent establishment when a person has a sales outlet. The term "sales outlet" is intended, however, to mean a place of business where the enterprise conducts activities which contribute significantly to the conclusion of sales, not a place where goods are merely delivered. The reference in subparagraph (e) to advertising, scientific research and supply of information is not intended to suggest that such activities are always auxiliary or that other activities cannot be auxiliary.

Paragraph 4 provides that if an enterprise of a Contracting State does not have a permanent establishment in the other Contracting State under paragraphs 1, 2 and 3, but goods or merchandise are either subjected to processing in that other Contracting State by another person (whether or not purchased in that other Contracting State), or are purchased in that other Contracting State (and such goods or merchandise are not subject to processing outside that other Contracting State), then such enterprise shall be considered to have a permanent establishment in that other Contracting State to the extent that all or part of such goods or merchandise is sold by or on behalf of such enterprise for use, consumption, or disposition in that other Contracting State.

Paragraphs 5 and 6 apply to the permanent establishment implications of employees and agents. Under paragraph 5 a person (other than an agent of an independent state to whom paragraph 6 applies) acting in a Contracting State shall be deemed to be a permanent establishment in the first-mentioned State of that enterprise if:

(a) he habitually exercises in that State an authority to conclude contracts in name of the enterprise, unless his activities are limited to those limited in paragraph 3 and are not described in paragraph 4; or,

(b) he habitually maintains in that State a stock of goods or merchandise from which he regularly delivers goods on behalf of the enterprise and additional activities conducted in that State on behalf of the enterprise have contributed to the conclusion of the sale of such goods or merchandise.

Thus, if a U.S. company that does not have a fixed place of business in Jamaica hires a person who does not have the power to conclude contracts on behalf of the company but who during a taxable year participates materially in Jamaica in the negotiation of contracts for the sale of goods on behalf of the company to residents of Jamaica, and regularly delivers such goods in Jamaica to the purchasers on behalf of the company, the person is considered to be a permanent establishment of the U.S. company if he habitually maintains in Jamaica a stock of goods from which he makes the deliveries.

Paragraph 6 provides that if an enterprise of one Contracting State merely carries on business in the other Contracting State through a broker or any other agent of independent status acting in the ordinary course of his business, the enterprise will not thereby be considered to have a permanent establishment in that other State. Paragraph 6 also provides, however, that such broker or agent will not be considered independent, and paragraph 6 shall not apply, if all his activities are devoted wholly, or almost wholly, on behalf of that enterprise and the transactions between the two are not conducted under arm's-length conditions.

Paragraph 7 provides that the fact that a company which is a resident of one Contracting State either controls or is controlled by a company which is a resident of the other Contracting State, or which is a resident of any State and carries on business in that other State, does not automatically render either company a permanent establishment of the other.

Article 6. INCOME FROM IMMOVABLE PROPERTY (REAL PROPERTY)

Paragraph 1 of this Article provides that income derived by a resident of a Contracting State from real property, including income from agriculture and forestry, may be taxed in the other Contracting State if the property is situated in that other State. This right to tax does not depend on whether the income is derived through a permanent establishment in that other State. Also, the Convention does not limit the amount of tax imposed by the other Contracting State on the real property income. In contrast, Article IX of the 1959 Convention imposes a limitation of 15 percent on the tax imposed on certain royalties in respect of the extraction of natural resources. Income derived from real property includes income from rights such as an overriding royalty or a net profits interest in a natural resource. Income in the form of rights to explore for or exploit natural resources which a person receives as compensation for services (e.g., exploration services) is, however, subject to the provisions of Article 7 (Business Profits), 14 (Independent Personal Services) or 15 (Dependent Personal Services), as the case may be, rather than the provisions of this Article.

Paragraph 2 defines real property as having the meaning it has under the laws of the Contracting State in which the property is situated. Paragraph 2 also provides that certain other types of property are included in the Convention definition of real property, notwithstanding domestic law definitions.

Paragraph 3 provides that the basic rule in paragraph 1 applies to income derived from the direct use, letting, or any other use of real property. Paragraph 4, provides that the rules of this Article apply to the income from immovable property of an enterprise or from property used for the performance of independent personal services.

Paragraph 5 of the U.S. Model, which provides a binding election to be taxed on a net basis, was omitted from the Convention; such an election is available under both U.S. and Jamaican domestic law.

Article 7. BUSINESS PROFITS

This Article provides rules for the taxation by a Contracting State of income from business activity carried on in that State by a resident of the other Contracting State.

Paragraph 1 provides that the business profits, as defined in paragraph 7, of an enterprise of a Contracting State shall be taxable only by that State except to the extent that such profits are attributable to a permanent establishment through which the enterprise carries on business in the other Contracting State. The term "permanent establishment" is defined in Article 5 (Permanent Establishment).

Paragraph 2 provides that the profits to be attributed to a permanent establishment are those which it might be expected to make if it were a distinct and independent enterprise engaged in the same or similar activities under the same or similar conditions. The term profits "attributable to" a permanent establishment means that the limited "force-of-attraction" rule of Code Section 864(c)(3) does not apply for U.S. tax purposes under the Convention. Profits may, however, be from sources within or without a Contracting State and be "attributable to" a permanent establishment. Thus, items of income described in section 864(c)(4)(B) of the Code which are attributable to a permanent establishment in the United States are subject to tax by the United States. In contrast, paragraph (1) of Article III of the 1959 Convention allows the United States to tax industrial and commercial profits only from sources within the United States.

Paragraph 3 provides that there shall be allowed as deductions those expenses incurred for the purposes of the permanent establishment, whether incurred in the State where the permanent establishment is located or elsewhere. While administrative expenses, research and development expenses, interest, and other expenses are not specifically listed in paragraph 3, such expenses are deductible pursuant to paragraph 3 wherever incurred if, of course, they are substantiated.

Paragraph 4 provides that the mere purchase by a permanent establishment of goods or merchandise for the enterprise shall not result in profits being attributed to the permanent establishment. Paragraph 5 provides that the same method for determining the profits attributable to a permanent establishment shall be used each year unless there is good and sufficient reason to change. In the United States, such a change may be a change of accounting method requiring the approval of the Internal Revenue Service.

Paragraph 6 provides that where business profits include items of income dealt with separately in other Articles of the Convention, then the provisions of those separate Articles override the provisions of Article 7. Thus, for example, the taxation of income from international shipping and transport dealt with in Article 8 (Shipping and Air Transport) is governed by that Article and not by Article 7. Similarly the taxation of dividends, interest, and royalties is controlled by Articles 10 (Dividends), 11 (Interest), and 12 (Royalties); however, those Articles provide that where dividends, interest, or royalties derived by a resident of a Contracting State are attributable to a permanent establishment of that resident in the other Contracting State, then the provisions of this Article, or Article 14 (Independent Personal Services), shall apply.

Paragraph 7 provides a definition of "business profits." Such profits are defined to mean income derived from the conduct of any trade or business, including the rental of tangible personal property and the furnishing of personal services of another person. Paragraph 7 clarifies that income derived from performance of personal services either as an employee or in an independent capacity is not within the definition of "business profits." Thus, as a generally matter, rental income derived by a resident of one Contracting State may not be taxed by the other Contracting State except to the extent attributable to a permanent establishment in the latter State. See, however, paragraph 3 of Article 12 (Royalties) which provides that payments for the use of, or the right to use, copyrights for work such as films are taxable in the Contracting State in which they arise, subject to the limitations imposed by Article 12, whether or not the owner of the payments has a permanent establishment in that State.

Article 8. SHIPPING AND AIR TRANSPORT

Paragraph 1 provides that profits of an enterprise of a Contracting State from the operation of ships or aircraft in international traffic shall be taxable only by that Contracting State. International traffic is defined in paragraph 1(d) of Article 3 (General Definitions). Thus, the other Contracting State may not tax such profits even if they are attributable to a permanent establishment on the enterprise in that other State. Unlike the 1959 Convention provision concerning shipping and aircraft (Article V), Article 8 does not list as a standard the place of registration of the ship or aircraft.

Paragraphs 2 and 3 clarify what income is to be considered profits from the operation of ships or aircraft. Paragraph 2 states that income from the operation of ships or aircraft in international traffic includes profits from the rental of ships or aircraft if operated in international traffic by the lessee, or if such rental profits are incidental to operating profits. Such "incidental" rental profits may include rents from bareboat charters.

Paragraph 3 states that profits of an enterprise of a Contracting State from the use, maintenance or rental of containers, and related equipment for the transport of containers, used for the transport of goods or merchandise in international traffic are taxable only by the Contracting State in which the enterprise is resident.

Paragraph 4 provides that the provisions of paragraphs 1 and 3 apply to profits from the participation in a pool, a joint business, or an international operating agency.

Article 9. ASSOCIATED ENTERPRISES

This Article confirms the power of the United States under Code section 482 to allocate items of income, deductions, credits, or allowances in certain cases. The Article also authorizes a Contracting State to, for example, reduce a proposed allocation by that State or make an adjustment of income or deductions corresponding to a proposed allocation by the other State to the extent necessary to prevent double taxation of income by the two Contracting States.

Pursuant to paragraph 1, if an enterprise subject to tax by a Contracting State and any other enterprise, whether or not a resident of a Contracting State, make arrangements or impose conditions which differ from those which would be made between independent enterprises, any income, deductions, credits or allowances which would, but for those conditions, have accrued to one of the enterprises may be taken into account in computing the amount included in the profits of that enterprise and taxed accordingly.

Paragraph 2 provides that where a redetermination has been made by a Contracting State to the income of an enterprise, then the other Contracting State shall, if it agrees with such redetermination and if necessary to avoid double taxation by the two Contracting States, make a corresponding adjustment to the income of the related enterprise in such other Contracting State. In the event that the Contracting State disagrees with such redetermination, then the competent authorities shall endeavor to resolve the matter in accordance with Article 26 (Mutual Agreement Procedure).

Paragraph 3 provides that an enterprise is related to another enterprise if either enterprise owns or controls directly or indirectly the other, or if any third person or persons own or control, directly or indirectly, both. The term "control" is defined broadly to include all forms of control, however exercisable.

Article 10. DIVIDENDS

Under paragraph 1 dividends paid by a company which is a resident of a Contracting State to a shareholder resident by the other Contracting State may be taxed by that other State. Such dividends may also be taxed by the State of which the company paying the dividends is a resident, but such tax may not be in excess of the rates specified in paragraph 2, which is amended by the 1981 Protocol: 10 percent of the dividends, where the beneficial owner is a company which owns, directly or indirectly, at least 10 percent of the voting stock of the company paying the dividends; and, 15 percent of the dividends in all other cases. Paragraph 2 does not affect the taxation of the company's profits out of which the dividends are paid.

Paragraph 3 defines "dividends", for the purposes of Article 10, as income from shares or other rights (not debt-claims) participating in profits, and income from other corporate rights taxed in the same way as income from shares under the tax law of the State of which the company making the distribution is a resident.

Paragraph 4 provides that where dividends otherwise taxable at source at 10 or 15 percent as provided in paragraph 2 are attributable to a permanent establishment or fixed base of the beneficial owner in the Contracting State of which the company paying the dividends is a resident, then the dividends are taxable by that State in accordance with the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), rather than under the provisions of paragraph 2 of this Article.

Paragraph 5 provides that the income of a Jamaican company derived from manufacture in Jamaica of approved products under the tax incentive legislation of Jamaica shall not be subject to the United States accumulated earnings tax. Generally, these companies are incorporated in Jamaica to manufacture approved products in Jamaica and to participate in a "pioneering activity." Such companies are subject to a reduced corporate profits tax by Jamaica. Paragraph 5 also provides that any company which is a resident of Jamaica shall be exempt from United States accumulated earnings tax if individuals (other than U.S. citizens) who are resident of Jamaica control, directly or indirectly, throughout the last half of the taxable year more than 75 percent of the entire voting power in that company.

Paragraph 6 provides that, as a general rule, a Contracting State may not impose tax on dividends paid by a company which is a resident of the other Contracting State. There are two exceptions to this rule: where dividends are paid to a resident of the first-mentioned State; and where dividends are attributable to a permanent establishment or fixed base in the first State. For example, if a corporation created under the laws of Jamaica is doing business in the United States and pays dividends, those dividends may be taxed by the United States if: paid to a resident (or citizen) of the United States; or if attributable to a permanent establishment or a fixed base in the United States. Thus, dividends paid by a Jamaican company with a permanent establishment in the United States, which has at least 50 percent of its gross income from all sources attributable to such permanent establishment, shall not be taxed by the United States even if such dividends are paid to a resident of a third State. See, however, Article 17 (Limitations on Benefits) for circumstances where this exemption from U.S. tax may not apply. Also this rule (and the rest of Article 10) is subject to the saving clause of paragraph 3 of Article 1 (Personal Scope). Finally, in the case of dividends paid by a company resident in a third State, see paragraph 3 of Article 23 (Other Income).

Article 11. INTEREST

This Article concerns the taxation by a Contracting State of interest arising in that State and derived and beneficially owned by a resident of the other Contracting State. Paragraph 1 provides that the other Contracting State may tax such interest. Paragraph 2 provides that the Contracting State in which the interest arises may also tax the interest, but the tax may not exceed 12.5 percent of the gross amount of the interest. There is no general interest article in the 1959 Convention. Thus, Jamaican and United States tax on interest derived by a resident of the other State is, in general, not limited by the 1959 Convention.

Paragraph 3 provides two exceptions to the rule in paragraph 2. Pursuant to these exceptions, interest is exempt from tax by the Contracting State in which the interest arises if it is derived by: the other Contracting State or an instrumentality thereof (including certain specificied entities such as the Bank of Jamaica and the U.S. Federal Reserve Banks, and such other institutions of the Contracting States as are specified in agreements entered into under Article 26 (Mutual Agreement Procedure)), or a resident of the other Contracting State with respect to debt obligations guaranteed or insured by that State or an instrumentality thereof.

Paragraph 4 contains the definition of interest found in the U.S. Model. Paragraph 4 omits, however, the U.S. Model statement that penalty charges for late payment shall not be regarded as interest.

Paragraph 5 provides that interest attributable to a permanent establishment or fixed base which the beneficial owner of the interest, being a resident of a Contracting State, maintains in the other Contracting State is taxable in accordance with the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), as the case may be, rather than under this Article.

Paragraph 6 identifies the place where interest is deemed to arise. Interest is deemed to arise in a Contracting State when the payer is that State, a political subdivision, a local authority, or a resident of that State. If, however, the interest is incurred in connection with a permanent establishment or fixed base in a Contracting State and such interest is allowable as a deduction in computing tax liability of the permanent establishment or fixed base in that State, then the interest is deemed to arise in that State, regardless of the payer's State of residence.

If an excessive amount of interest is paid by reason of a special relationship between the payer and beneficial owner of interest, or between both of them and a third person then, pursuant to paragraph 7, the provisions of Article 11 shall only apply to the portion of the payment which would have been agreed upon in the absence of such special relationship. The excess amount may be taxed by each Contracting State, in accordance with its own law, including the Convention where applicable. In the case of the United States, the excess amount may, for example, be taxed as a dividend, in which case the provisions of Article 10 (Dividends) may apply.

Note that Article 11 does not preclude the application by the United States of tax on interest paid to a beneficial owner resident in Jamaica by a company resident in Jamaica or a third State if the interest arises in Jamaica and the requirements of the Code for the imposition of such tax are satisfied. The United States tax on such interest beneficially owned by a Jamaican resident is limited by paragraph 1 to 12.5 percent.

Article 12. ROYALTIES

Paragraph 1 provides that royalties arising in a Contracting State which are derived and beneficially owned by a resident of the other Contracting State may be taxed by that other state. Paragraph 2 provides that the State in which the royalty arises may also tax the royalty, but the tax may not exceed 10 percent of the royalty. Paragraph 3 contains the definition of royalty found in the U.S. Model, but treats as royalties payments received as consideration for the use of cinematograph films, or films or tapes used for radio or television. Also, paragraph 3 specifies that the term "royalties" does not include payments for the use of tangible personal property. Such payments are taxable as provided in Articles 7 (Business Profits) or 14 (Independent Personal Services), as the case may be. The term "royalties" does not encompass management fees, which are covered by the provisions of Article 7 or 14, or payments under a bona fide cost-sharing arrangement. Technical service fees may be royalties in cases where the fees are periodic and dependent upon productivity or a similar measure.

Paragraph 4 provides that royalties attributable to a permanent establishment or fixed base which the beneficial owner of the royalties being a resident of a Contracting State maintains in the other Contracting State are taxable in accordance with the provisions of Article 7 or Article 14, as the case may be, rather than under this Article.

If an excessive amount of royalty is paid by reason of a special relationship between the payer and the beneficial owner of the royalty, or between both of them and a third person, then pursuant to paragraph 5 the provisions of Article 12 shall only apply to the portion of the payment which would have been agreed upon in the absence of the special relationship. The excess amount may be taxed by each Contracting State, in accordance with its own law, including the Convention where applicable. In the case of the United States, the excess amount may, for example, be taxed as a dividend, in which case the provisions of Article 10 (Dividends) may apply.

Paragraph 6 identifies the State in which royalties are deemed to arise. The general rule is that royalties arise in a Contracting State when the payer is that State itself, a political subdivision or local authority, or a resident of that State. Payments for the use of or the right to use property or rights in a Contracting State are deemed, however, to arise in the State in which they are used. This rule reflects the U.S. statutory rule, which sources royalties in the State in which the property or rights are used. Thus, if a U.S. resident licensor receives royalties from a resident of Jamaica for the use of a patent in Jamaica or in a third State the royalty will be deemed to arise in Jamaica. If, however, the Jamaican resident uses the patent in the United States, the royalty will be deemed to arise in the United States. These rules are relevant for purposes of calculating the U.S. foreign tax credit for Jamaican income taxes. See paragraphs 1 and 3 of Article 24 (Relief from Double Taxation).

Article 13. CAPITAL GAINS

Paragraph 1 provides that gains from alienation of real property may be taxed by the Contracting State in which the property is situated. In that connection, paragraph 5 further provides that gains from the alienation of stock of a company or an interest in a partnership, trust or estate, the value of which is derived principally from real property may also be taxed by the Contracting State in which such real property is situated. In determining whether the value of stock of a company or an interest in a partnership, trust or estate is principally from real property, one takes into account any stock or interests in entities the direct disposition of which would be subject to tax under paragraph 5.

Paragraph 2 provides that a Contracting State may tax gains from the alienation of movable property forming part of the property of a permanent establishment or pertaining to a fixed base in that State which belongs to a resident of the other Contracting State.

Paragraph 3 further provides that gains derived by an enterprise of a Contracting State from the alienation of ships, aircrafts, or containers operated in international traffic shall be taxable only in that State (i.e., the State of residence).

Paragraph 4 allows Jamaica to impose its transfer tax upon the alienation of property pursuant to its Transfer Tax Act, as in effect on May 21, 1980.

Paragraph 6 provides that alienation of any property not referred to in paragraphs 1, 2, 3, 4 and 5 shall be taxable only in the Contracting State of which the alienator is resident.

Paragraph 7 allows a Contracting State to tax gains from the alienation of property derived by an individual who was a citizen of that State at any time during the ten year period immediately preceeding the taxable year in which the property was alienated. In the case of a U.S. citizen such gains are taxable by the United States also pursuant to paragraph 3 of Article 1 (Personal Scope).

The term "gains" includes amounts taxed as capital gains and as ordinary income.

Article 14. INDEPENDENT PERSONAL SERVICES

Unlike the 1959 Convention, this Convention provides two separate Articles—Articles 14 and 15—dealing with the taxation of income from independent and dependent personal services. In addition, the rules of Articles 14 and 15 differ from rules of the 1959 Convention concerning the taxation of services income. See Article XI of the 1959 Convention.

Independent personal services are, in general terms, services performed by an individual for his own account where he receives the income and bears the losses arising from the services. Generally, services rendered by persons such as physicians, lawyers, engineers, architects, dentists and accountants as sole proprietors or partners, are independent personal services, whereas services performed as an employee or as an officer of, for example, a company constitute dependent personal services.

Paragraph 1 of this Article provides that income derived by an individual who is a resident of a Contracting State from the performance of personal services in an independent capacity shall generally not be taxable in the other Contracting State. However, such income may also be taxed in the other Contracting State if such services are performed in that other State and either: the income is attributable to a fixed base in that other State which the individual has regularly available for the purpose for performing his activities; the individual is present in that other State for 90 days or more in the taxable year; or, net income derived by the individual from residents of that other State exceeds $5,000 (or its equivalent in Jamaican dollars) during the taxable year. In the third case, if the net income exceeds $5,000, the entire amount may be taxed by the other State.

The term "fixed base" is not defined but, in general, is intended to be the same as a permanent establishment.

Article 15. DEPENDENT PERSONAL SERVICES

This Article generally provides that, subject to the provisions relating to directors' fees (Article 16), artistes and athletes (Article 18), pensions and annuities (Article 19) and government services (Article 20), remuneration derived by a resident of a Contracting State in respect of an employment may be taxed only by that State unless and to the extent that such remuneration is for employment exercised in the other Contracting State, in which case the latter State may also tax such remuneration. Even if the employment is exercised in the other Contracting State, however, such remuneration is taxable only in the person's State of residence if his net income in the taxable year from such employment in the other State is not more than $5,000 (or its equivalent in Jamaican dollars); or, he is present in the other State for not more than 183 days in the taxable year, he is paid by, or on behalf of, an employer who is not a resident of the other State, and the remuneration is not deductible in computing taxable income of a permanent establishment or fixed base of the employer in the other State.

Paragraph 3 provides a special rule for remuneration derived by members of the regular complement of ships or aircraft operated by an enterprise of a Contract State in international traffic. Such remuneration is taxable only by the Contracting State of which the enterprise operating the ship or aircraft is resident.

Article 16. DIRECTORS' FEES

This Article provides that a resident of a Contracting State who derives fees for services performed in the other Contracting State as a director of a company resident in that other State may be taxed by that State on such fees except where the amount of such fees, not including expenses reimbursed to him or borne on his behalf, does not exceed $400 (or its equivalent in Jamaican dollars) per day for each day such person is present in that other State for the purpose of performing such services. In the event that the director's fees exceed the daily allowance, the full amount of such fees is subject to tax by that other State.

Article 17. LIMITATIONS ON BENEFITS

Article 17, which is amended by the 1981 Protocol, assures that source basis tax benefits granted by a Contracting State pursuant to the Convention go to the intended beneficiaries—the residents of the other Contracting State—and not to residents of third States not having a substantial business and tax nexus with the other Contracting State. In the absence of Article 17, residents of a third State might organize a company in a Contracting State for the purpose of, for example, claiming preferential source basis tax rates in the other Contracting State.

Paragraph 1 provides that any person other than an individual (e.g., a company or a trust), which is a resident of a Contracting State shall not be entitled to relief from source basis tax under the Convention in the other Contracting State unless:

(a) more than 75 percent of the beneficial interest in such person is owned, directly or indirectly, by one or more individuals resident in the first-mentioned State; and

(b) the income of such person is *not* used in substantial part, directly or indirectly, to meet liabilities to persons who are residents of third States, other than any resident of a third State who is a citizen of either of the Contracting States and taxable by such State on his worldwide income on the basis of citizenship.

The term "liabilities" used in subparagraph (b) of paragraph 1 includes liabilities for items such as interest or royalties. A company that has substantial trading in its stock on a recognized exchange in either of the Contracting States is presumed, solely for purposes of subparagraph (a), to be owned by individuals resident in the Contracting State in which the company itself is resident (as determined under Article 4 (Residence)). Thus, a Jamaican company having substantial trading in its stock on a recognized exchange in Jamaica or in the United States is presumed to be owned by residents of Jamaica and, therefore, is presumed to satisfy the requirements of subparagraph (a). Paragraph 1 applies to relief from taxation that would otherwise be granted pursuant to provisions such as Article 7 (Business Profits), Article 8 (Shipping and Air Transport), Article 10 (Dividends), Article 11 (Interest), Article 12 (Royalties), and Article 13 (Capital Gains).

Paragraph 2 provides that a person who cannot, or does not, demonstrate that the requirements of paragraph 1 are met may obtain source basis tax benefits under the Convention by demonstrating that the acquisition, ownership or maintenance of such person, and the conduct of such person's operations did not have as a principal purpose obtaining such benefits under the Convention. Paragraph 3 illustrates circumstances where the requirements of paragraph 2 have been satisfied. As explained in the Exchange of Notes accompanying the Protocol, paragraph 3 is not intended to suggest that the requirements of paragraph 2 cannot be met in other circumstances, not to limit the factors that may be taken into account in determining whether the requirements of paragraph 2 have been met.

Article 18. ARTISTES AND ATHLETES

This Article deals with the taxation of income derived by a resident of a Contracting State as a entertainer, musician or athlete from the performance of services as such in a Contracting State. Paragraph 1 overrides the provisions of Article 14 (Independent Personal Services) and Article 15 (Dependent Personal Services) to allow the other State to tax such income, where the latter Articles would not permit such taxation, but only if the gross receipts for such services, not including expenses reimbursed to the artiste or athlete or borne on his behalf, exceeds $400 (or its equivalent in Jamaican dollars) per day of performance or $5,000 (or its equivalent in Jamaican dollars) in the taxable year. If such gross receipts exceed $400 per day or $5,000 per year, the full amount, not just the excess, is subject to tax by the Contracting State in which the services are performed. Income derived from services rendered by persons such as producers, directors and technicians and others who are not artistes and athletes is taxable in accordance with the provisions of Article 14 or Article 15, as the case may be.

Paragraph 2 deals with cases in which income in respect of the activities of an entertainer or athlete accrues to a person other than, or in addition to, the entertainer or athlete; e.g., where the entertainer performs services as an employee of, or a contractor for, a corporation or other person. Paragraph 2 provides that income in respect of the personal activities of an artiste or athlete which accrues to the benefit of another person, including a company, trust, or partnership, may, notwithstanding the provisions of Articles 7 (Business Profits), 14 and 15 be taxed in the Contracting State in which the activities of the entertainer or athlete take place. Thus, such other person could not claim the permanent establishment protection otherwise provided by Article 7. For purposes of paragraph 2, income is considered not to accrue to another person if it is established that neither the artiste or athlete, nor any persons related to him, has a right to participate directly or indirectly in the profits of such other person, in any manner, including the receipt of deferred compensation, bonuses, fees, dividends, partnership distributions, or other distributions. A person may be considered related to the artiste or athlete regardless of whether the person is considered to be related to him under the provisions of paragraph 5 of Article 9 (Associated Enterprises). Paragraph 2 does not affect the rule of paragraph 1 that applies to the entertainer or athlete himself.

Article 19. PENSIONS, etc.

Article 19 provides rules concerning the taxation of pensions, social security payments, annuities, alimony, and child support. Paragraph 1 provides that, in general, pensions and other similar remuneration beneficially derived by a resident of a Contracting States in consideration of past employment shall be taxable only by that State. However, the other Contracting State may also tax such pension if the past employment to which the pension is attributable was performed in that other State while the person was a resident of that State. Social security payments and other public pensions paid by a Contracting State to a resident of the other Contracting State (or to a citizen of the United States resident in any State) are taxable only by the Contracting State making the payments. See paragraph 2 of Article 20 (Government Service) with respect to the taxation of pensions in respect of services rendered to a Contracting State.

Paragraph 2 provides that annuities beneficially derived by a resident of the Contracting State are generally taxable only in that State. If, however, an annuity was purchased in the other Contracting State while such person was a resident of that other State, the annuity may also be taxed by that other State. Paragraph 2 defines the term annuities to mean a stated sum paid periodically at stated times during life or during a specified number of years, under an obligation to make the payments in return for adequate and full consideration, other than services rendered.

Paragraph 3 provides that alimony paid to a resident of a Contracting State by a resident of the other Contracting State is exempt from tax by that other State. The term "alimony" is defined as periodic payments made pursuant to a written separation agreement or a decree of divorce, separate maintenance, or compulsory support, which payments are taxable to the recipient under the laws of the State of which he is a resident. Thus, if a U.S. resident makes periodic payments pursuant to a written separation agreement to a resident of Jamaica and such amounts are taxable to the Jamaican resident under the laws of Jamaica, such alimony is exempt from U.S. tax (unless the Jamaican resident is a U.S. citizen). If the amounts are not taxable to the Jamaican recipient under the laws of Jamaica then U.S. tax may be imposed at statutory rates (i.e., currently at 30 percent of the gross amount).

Paragraph 4 provides that both Contracting States shall exempt from tax periodic payments for the support of a minor child made pursuant to a written separation agreement or decree of divorce, separate maintenance, or compulsory support, paid by a resident of one Contracting State to a resident of the other Contracting State.

Article 20. GOVERNMENT SERVICE

Paragraph 1 provides that, as a general rule, remuneration other than pensions paid by a Contracting State, or a political subdivision or local authority thereof to any individual for services rendered to that State, subdivision or authority shall be taxable only by that State. Paragraph 1 also provides, however, that such remuneration shall be taxable only by the other Contracting State if the services are rendered in that other State by an individual who is a resident and national of that other State. Thus, if a Jamaican citizen and resident is employed by the Government of the United States and is rendering services in Jamaica, only Jamaica may tax his wages.

Paragraph 2 provides that a pension paid by a Contracting State or a political subdivision or a local authority thereof to any individual as consideration for services rendered to that State or subdivision or local authority is taxable only by that State. If, however, the recipient is both a national and a resident of the other State, and was a national of that State at the time the services were rendered, then such income is taxable only by that other Contracting State.

Pursuant to paragraph 3, the provisions of Article 20 apply only to remuneration and pensions in respect of governmental services. Remuneration and pensions in respect of services performed in connection with a business carried on by a Contracting State or a political subdivision or local authority thereof are taxable under the provisions of Articles 14 (Independent Personal Services), 15 (Dependent Personal Services), 18 (Artistes and Athletes), and 19 (Pensions, etc.). Whether services are governmental or performed in connection with a business is determined under the laws of the Contracting State where the services are performed.

Pursuant to paragraph 4(b) of Article 1 (Personal Scope), the benefits of Article 20 conferred by a Contracting State are not subject to the saving clause in paragraph 3 of Article 1, in the case of individuals who are neither citizens of nor have immigrant status in that State. In other cases, the saving clause does apply.

Article 21. STUDENTS AND TRAINEES

Paragraph 1 provides that a resident of one of the Contracting States who goes to the other Contracting State for the purpose of full-time education or training shall be exempt from tax by that other Contracting State on payments made to him from sources outside that State for the purpose of his maintenance, education or training.

Paragraph 2 provides that an individual who is a resident of a Contracting State at the time he becomes temporarily employed in the other Contracting State for the primary purpose of acquiring technical, professional or business experience from a person other than the person who employed him in the first-mentioned Contracting State, or a person related to such person, or studying at a university or other recognized educational institution shall be exempt from tax by that other Contracting State for a period not exceeding 12 consecutive months with respect to his net income from personal services in an amount not in excess of $7,500, or its equivalent in Jamaican dollars. Thus, a resident of Jamaica employed by a company resident in Jamaica, who trains for a period of 12 months at a salary of $7,500 in the United States with an unrelated company, and in order to acquire technical skills, is exempt from United States tax on such income.

Paragraph 3 provides that a student or trainee to whom paragraph 1 or 2 would otherwise apply may elect to be treated for tax purposes as a resident of the State which he is visiting for the purposes of his education or training. Under this rule, a Jamaican resident who comes to the United States as a student or trainee may elect to be taxed on his worldwide income by the United States and to claim the same deductions and personal exemptions which are available to U.S. residents. He would be considered a resident of the United States for purposes of this Convention. Such an election would benefit a student or trainee with limited income, principally from U.S. sources, especially if he is supporting dependents, since a nonresident alien is only allowed one personal exemption. The election would presumably not be made by a student or trainee with large amounts of foreign source income, because if he so elects, his foreign source income would become subject to U.S. tax. Once the election is made, it may not be revoked during the time the person qualifies for treatment under paragraph 1 or 2, except with the consent of the competent authority of the host State.

The benefits conferred by the host State under this Article are not subject to the saving clause in paragraph 3 of Article 1 (Personal Scope), with respect to individuals who are neither citizens of nor have immigrant status in that State. In other cases, the saving clause does apply.

Article 22. TEACHERS AND RESEARCHERS

The Article provides that if an individual who is a resident of one of the Contracting States visits the other Contracting State for a period not expected to exceed two years for the purpose of teaching or engaging in research at a university, college, school, or other educational institution in that other State, the remuneration paid to him in that other State for a period not exceeding two years from the date of his first visit for such purpose shall be exempt from tax by that other State. Paragraph 2 only applies to income from research if the research is undertaken by the individual in the public interest; paragraph 2 does not apply to income from research carried on primarily for the benefit of some other private person or persons. An individual shall be entitled to the benefits of paragraph 1 only once.

The benefits conferred by the host State under this Article are not subject to the saving clause in paragraph 3 of Article 1 with respect to individuals who are neither citizens of nor have immigrant status in that State. In other cases, the saving clause does apply.

Article 23. OTHER INCOME

This Article provides in paragraph 1 that, in general, any income of a resident of a Contracting State which is not dealt with in the foregoing Articles of the Convention, such as prizes and awards, shall be taxable only by that State. This rule is not confined to income from the other Contracting State, but applies, as well, to income arising in third States.

Paragraph 2 excepts from the rule of paragraph 1 income derived by a resident of a Contracting State which is attributable to a permanent establishment or fixed base of that resident in the other Contracting State. In such a case, the income is covered instead under the Articles dealing with business profits (Article 7), independent personal services (Article 14), or artistes and athletes (Article 18). Thus, for example, income of a U.S. resident from real property situated in a third State, which is attributable to a permanent establishment of such person in Jamaica would be subject to tax by Jamaica.

Paragraph 3 provides that, notwithstanding paragraphs 1 and 2, items of income of a resident of a Contracting State not dealt with in the foregoing Articles of the Convention and arising in the other Contracting State may be taxed by that other State.

Article 24. RELIEF FROM DOUBLE TAXATION

Paragraph 1 provides that the United States shall give a foreign tax credit for the appropriate amount of income taxes paid or accrued to Jamaica. Paragraph 1 provides a credit both for Jamaican taxes imposed on a recipient of income arising in Jamaica, and in the case of a U.S. company owning at least 10 percent of the voting power of a company resident in Jamaica from which the U.S. company receives dividends in the taxable year, the appropriate amount of Jamaican taxes paid or accrued by the Jamaican company with respect to the profits out of which it paid dividends. In this regard, the Jamaican taxes referred to in paragraphs 2(b) and 3 of Article 2 (Taxes Covered) are considered to be income taxes for purposes of paragraph 1, whether or not such payments are income taxes under the Code. As noted in the discussion of paragraph 3 of Article 2, however, any tax imposed by Jamaica, whether by statute or by contract, in lieu of the income tax or the company profits tax must meet the requirements of Code section 903. If Jamaica were to modify by contract a tax described in paragraphs 2(b) and 3, that contractual tax would be creditable for U.S. purposes if it met the requirements of Code section 901 or 903. Further, whether Jamaican taxes are paid or accrued is determined under the rules of the Code.

The amount of credit granted under the Convention for Jamaican taxes is subject to the limitations provided by United States law for the taxable year for the purposes of limiting the credit to the U.S. tax on income from sources outside of the United States. Paragraph 3, which identifies the source of income and profits for the purposes of Article 24, provides the source rules necessary to compute the foreign tax credit under the Convention. A taxpayer may, for any year, claim a foreign tax credit under the rules of the Code. Thus, he would forego the rules of the Convention that guarantee income tax status for the specified Jamaican taxes.

The source rules of paragraph 3 provide that the source of:

(a) dividends described in Article 10, is in the State of residence of the paying company;
(b) interest, as defined in Article 11 (Interest), is in the State specified in paragraph 6 of Article 11;
(c) royalties, as defined in paragraph 3 of Article 12 (Royalties), is in the State specified in paragraph 6 of Article 12; and
(d) except for the just-mentioned dividends, interest and royalties, dividends and interest de-

rived from a dual resident company described in paragraph 3 of Article 4 (Residence), and income described in paragraph 3 of Article 23 (Other Income), income or profits derived by a resident of a Contracting State which may be taxed by the other Contracting State (other than solely by reason of citizenship) are deemed to arise in that other State.

Paragraph 2 provides that, subject to the provisions and limitations of Jamaican law regarding the allowance of foreign tax credits, Jamaica will allow to a resident of Jamaica as a credit against Jamaican tax on income the appropriate amount of income tax paid or accrued to the United States. In the case of dividends from a United States company to a Jamaican company which owns at least 10 percent of the voting power of the U.S. company, Jamaica will also allow a credit for the appropriate amount of United States tax imposed with respect to the profits out of which dividends are paid. The U.S. taxes referred to in paragraph 2(a) and 3 of Article 2 are considered to be income taxes for purposes of applying the Jamaican credit in relation to U.S. taxes.

The saving clause in paragraph 3 of Article 1 (Personal Scope) does not apply to this Article. Thus, the provisions of this Article may be relied upon by a citizen or resident of a Contracting State.

Article 25. NON-DISCRIMINATION

Paragraph 1 provides that nationals of a Contracting State (e.g., individuals and companies) shall not be treated less favorably with respect to taxation and connected requirements by the other Contracting State than are nationals of that other Contracting State in the same circumstances. Nationals who are subject to tax on their worldwide income by a Contracting State are not in the same circumstances as nationals of another State who are not taxed on their worldwide income by the first-mentioned State. Thus, the United States is not obligated to treat a national of Jamaica who is a resident of a third State in the same manner as a United States national who is a resident of that third State.

Paragraph 2 provides that a Contracting State may not impose more burdensome taxes on a permanent establishment in that State of an enterprise of the other Contracting State than the first-mentioned State imposes on its own enterprises carrying on the same activities.

Paragraph 3 prohibits discrimination in the matter of deductions. Interest, royalties, and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State must be deductible disbursements for determining taxable profits in the first-mentioned State under the same conditions as if they had been paid to a resident of the first-mentioned State. Exceptions to this rule arise where the provisions of paragraph 1 of Article 9 (Associated Enterprise) paragraph 7 of Article 11 (Interest) or paragraph 5 of Article 12 (Royalties) apply. The term "other disbursements" includes a reasonable allocation of executive and general administrative expenses, research and development expenses, and other expenses incurred for the benefit of a group of related enterprises.

Paragraph 4 requires that a Contracting State not impose more burdensome taxation on an enterprise of that State owned by residents of the other Contracting State than the first-mentioned State imposes on other similar enterprises of that State.

Paragraph 5 repeats the statement of paragraph 4 of Article 2 (Taxes Covered) that Article 25 applies to taxes of every kind and description imposed by a Contracting State or a political subdivision or local authority.

Paragraph 6 provides two exceptions to coverage of this Article. Subparagraph (a) clarifies that a Contracting State is not obligated to grant to individuals not resident in that State personal allowances, reliefs or credits for taxation that it grants individuals who are so resident. Subparagraph (b) allows Jamaica to charge a higher rate of income tax under section 48(5) of the Income Tax Act of Jamaica on life insurance companies which are residents of the United States than on a regionalized life assurance company.

Paragraph 7, added by the July 17, 1981 Protocol, allows U.S. income tax deductions for certain convention expenses that, absent paragraph 7, would not be deductible in computing U.S. tax liability because of Code section 274(h). Paragraph 7 provides that specified expenses incurred by a U.S. citizen or resident in connection with attendance at a convention, seminar or similar meeting held in Jamaica shall be deductible for U.S. tax purposes to the same extent as if the meeting were held in the United States. Paragraph 7 allows deductions only for ordinary and necessary business expenses for: lodging, meals and the personal sustenance and comfort of the traveler while at the convention in Jamaica; registration at the convention and books and other similar materials necessary for attendance at the convention; ground and air transportation to and from the convention site, but not in excess of the amount deductible under the Code with respect to transportation expenses incurred in connection with travel outside the United States. Thus, the deductibility of transportation expenses is subject to the rules of Code section 274(c). A U.S. taxpayer can claim benefits under section 274(h) with respect to a convention held in Jamaica and meeting the requirements of that section or, in the alternative, he can choose to rely on the provisions of paragraph 7 with respect to the expenses attributable to the convention if the provisions of paragraph 7 prove more beneficial.

The provisions of this Article do not override the right of the United States to impose the tax provided in Code section 897 (relating to gains derived by nonresident aliens or foreign corporations from U.S. real property interests).

The saving clause in paragraph 3 of Article 1 (Personal Scope) does not apply to Article 25.

Article 26. MUTUAL AGREEMENT PROCEDURE

Paragraph 1 provides that a person who considers that the actions of one or both of the Contracting States result, or will result, for him in taxation not in accordance with the Convention, he may present his case to the competent authority of the State of which the person is a resident or national. The person need not first have exhausted the remedies available to him in the domestic laws of the Contracting States. Paragraph 1 specifies that a resident of a Contracting State who has a permanent establishment or a fixed base in the other Contracting State may present his case to the competent authority of either Contracting State.

Paragraph 2 provides that the competent authority, if it considers the objection to be justified, and if it is not able to arrive at a satisfactory solution itself, shall endeavor to resolve the case by mutual agreement with the competent authority of the other Contracting State in order to avoid taxation not in accordance with the Convention. Any agreement so reached shall be implemented without regard to any statutory time limits of the Contracting States. In the case of Jamaica, however, the taxpayer or the U.S. competent authority must give notice to the Jamaican competent authority of the possible claim for tax adjustment within the statutory time limits of Jamaica. Thus, if a taxpayer notifies the competent authority of Jamaica of a possible claim for an adjustment of Jamaican tax within the time provided in Jamaica's statute of limitations, then the taxpayer may file its formal claim for refund from Jamaica after the expiration of the Jamaican statute of limitations and still have such claim considered by Jamaica. Paragraph 2 does not, however, obligate the U.S. competent authority to reduce or waive a proposed U.S. tax adjustment, such as an adjustment concerning associated enterprises, if timely notice is not given to the Jamaican competent authority of a possible corresponding adjustment of Jamaican tax.

Paragraph 3 provides that the competent authorities shall endeavor by mutual agreement to resolve any difficulties or doubts which may arise as to the interpretation or application of the Convention. They may also consult together to eliminate double taxation in cases not specifically provided for in the Convention. The competent authorities may, for example, agree to:

(a) the attribution of income, deductions, credits, or allowances of an enterprise of a Contracting State to its permanent establishment in the other Contracting State;
(b) the allocation of income, deductions, credits, or allowances between persons;
(c) the characterization of items of income;
(d) the application of source rules; and
(e) the meaning of a term.

Thus, the competent authorities may agree to a common method of treating an issue in the interest of avoiding double taxation by the two Contracting States.

Paragraph 4 provides that the competent authorities may communicate with each other directly for the purpose of reaching agreement in accordance with Article 26.

Paragraph 5 provides that the competent authorities may agree to increase any dollar amounts specified in the Convention. Such increases would be made to reflect monetary or economic developments. Thus, if the competent authorities agree that due to inflation in the two Contracting States the $5,000 threshold for the taxation of service income provided in paragraph 1(c) of Article 14 (Independent Personal Services) is no longer adequate given the purposes of Article 14, they may agree to a higher amount.

Article 27. EXCHANGE OF INFORMATION

Paragraph 1 provides that the competent authorities shall exchange such information as is necessary for carrying out the provisions of the Convention or of their domestic laws concerning taxes covered by the Convention. Paragraph 1 clarifies that the competent authorities may also exchange such information as is necessary to prevent fraud or tax evasion in respect of taxes covered by the Convention. Paragraph 1 requires that information so exchanged will be protected in the same manner as information obtained under domestic laws with respect to secrecy and disclosure. The use of such information is limited to those persons involved in the assessment, collection and enforcement of taxes covered in the Convention. Information may be exchanged pursuant to paragraph 1 with respect to persons who are not residents of either Contracting State.

The provisions of paragraph 1 are intended to authorize the U.S. competent authority to allow the General Accounting Office access to tax return information received from Jamaica when GAO is engaged in a study of the administration of U.S. tax laws pursuant to a directive of Congress. The secrecy requirements of paragraph 1 must, however, be met.

Paragraph 2 provides that the State to which a request has been made shall provide information in specified forms to be admissible in judicial proceedings of the requesting State. The specified forms include authenticated copies of unedited original documents, but only to the extent that such forms of information can be obtained under the laws and practices of the State with respect to its own taxes.

Paragraph 3 explains that paragraphs 1 and 2 do not obligate the United States or Jamaica to carry out measures contrary to the laws and administrative practice of either State; to supply information not obtainable under the laws or in the normal course of the administration of either State; or to supply information which would disclose trade secrets or other information the disclosure of which would be contrary to public policy. Thus, Article 27 allows, but does not obligate, the United States and Jamaica to obtain and provide information the disclosure of which would not be available to the requesting State under its laws or administrative practice or that in different circumstances would not be available to the State requested to provide information. Further, Article 27 authorizes a Contracting State to obtain information for the other Contracting State even if there is no tax liability in the State requested to obtain the information.

Paragraphs 4 and 5 provide for assistance in collection of taxes, within the parameters of a Contracting State's domestic tax laws, sovereignty, security and public policy, to ensure that Convention benefits do not accrue to persons not entitled thereto.

Paragraph 6 provides that the competent authorities may exchange information concerning every tax imposed by a Contracting State, not just the taxes listed in paragraph 2 of Article 2 (Taxes Covered)

Article 28. DIPLOMATIC AGENTS AND CONSULAR OFFICERS

This Article provides that this Convention shall not affect taxation privileges of diplomatic or consular officials under the rules of special agreements or international law.

Article 29. ENTRY INTO FORCE

Paragraph 1 provides that the Convention be ratified by the Contracting States in accordance with their applicable procedures and that the instruments of ratification be exchanged at Washington as soon as possible.

Paragraph 2 provides that the Convention will enter into force upon the exchange of instruments of ratification. Once the Convention enters into force it shall have effect:

(a) in respect of tax withheld at the source, to amounts paid or credited on or after the first day of the second month next following the date on which the Convention enters into force;

(b) in respect to other taxes, to taxable periods beginning on or after the first day of January next following the date on which the Convention enters into force.

Paragraph 3 provides for the termination of the 1959 Convention. The 1959 Convention shall cease to have effect with respect to the United States and Jamaica from the date on which the corresponding provisions of this Convention have effect according to paragraph 2.

Article 30. TERMINATION

The Convention shall remain in force unless terminated by one of the Contracting States. Either Contracting State may terminate the Convention at any time after five years from the date on which it enters into force by giving at least six months' prior notice through diplomatic channels. In that event, the Convention shall cease to have effect:

(a) in respect of tax withheld at the source, to amounts paid or credited on or after the first of January following the expiration of the six months' period of notice (i.e., if notice is given by June 30 of one year, the termination will be effective on January 1 of the following year);

(b) in respect of other taxes, to taxable periods beginning on or after the first day of January next following the expiration of the six months' period.

Subpart B.-Legislation and Related Committee Reports

Public Law 97-21 [1]

97th Congress, H.J. Res. 238
July 9, 1981

Joint Resolution

To approve a Constitution for the United States Virgin Islands.

Whereas the Congress, recognizing the basic democratic principle of government by the consent of the governed enacted Public Law 94-584 authorizing the peoples of the Virgin Islands to organize a government pursuant to a constitution of their own adoption; and

Whereas a constitution to provide for local self-government for the peoples of the United States Virgin Islands has been submitted to the Congress pursuant to the provisions of Public Law 94-584; and

Whereas, on April 24, 1981, the Virgin Islands Constitutional Convention recommended certain amendments to said proposed constitution: Now, therefore, be it

Resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That the Constitution for the United States Virgin Islands is approved for submission to the people of the Virgin Islands in accordance with the provisions of Public Law•94-584 (90 Stat. 2809) as follows:

* * * * *

ARTICLE XI. TAXATION AND FINANCE

TAX AUTHORITY

SECTION 1. All taxes shall be levied by law, and the Senate may not surrender, suspend, or contract away its power to initiate tax legislation except as provided by this Constitution. A tax may be levied or an appropriation of public money made only for a public purpose.

INCOME TAX

SECTION 2. Laws shall be enacted to administer and enforce the income tax and the Federal tax laws applicable to the Virgin Islands.

* * * * *

PUBLIC DEBT LIMITATION

SECTION 3. (a) The Senate by law may cause bonds or other obligations to be issued on behalf of the Government either for (i) a public improvement or public undertaking or (ii) other projects nominally and/or beneficially privately owned which will promote the public interest through economic development. Such bonds or obligations shall be payable solely from the revenues directly derived from and attributable to such public improvement, public undertaking, or other project. Such bonds shall not constitute a general obligation of the Virgin Islands or of the United States.

(b) The Senate, as authorized by law, may cause to be issued such negotiable general obligation bonds or other evidence of indebtedness as it may deem necessary and advisable to achieve or further a public purpose: *Provided*, That no public indebtedness of the Virgin Islands shall be incurred in excess of 10 percent of the assessed valuation of the taxable real property in the Virgin Islands.

* * * * *

All such bonds shall be sold for not less than the principal amount thereof plus accrued interest. All bonds issued by the Government of the Virgin Islands, specifically including interest thereon, shall be exempt from taxation by the Government of the United States; by the Government of the Virgin Islands or any political subdivision thereof; by any State, territory or possession or any political subdivision thereof, or by the District of Columbia.

* * * * *

---

[1] This publication of the law is restricted to excerpts involving tax matters; House Report No. 97-25 and Senate Report No. 97-66 are not published.

TRANSITIONAL SCHEDULE

RATIFICATION AND EFFECTIVE DATE OF THE CONSTITUTION

SECTION 1. This Constitution, as finally approved or modified by the Congress of the United States under Section 5 of Public Law 94-584 (October 12, 1976), shall be submitted to the qualified voters of the Virgin Islands and shall be ratified upon the affirmative vote of a majority of those voting on the question. The Constitution shall take effect one hundred and twenty days after ratification; except as provided in Sections 2 and 5 of this Transitional Schedule.

* * * * *

SEC. 2. Notwithstanding the time limitations for congressional review provided in Public Law 94-584 (90 Stat. 2899), the Constitution of the Virgin Islands, as approved by section 1 of this resolution, shall be submitted to the qualified voters of the Virgin Islands for acceptance or rejection as provided in section 5 of said Act.

Approved July 9, 1981.

Public Law 97-51 [1]

97th Congress, H.J. Res. 325

October 1, 1981

Joint Resolution making continuing appropriations for the fiscal year 1982, and for other purposes.

* * * * *

SEC. 119. (a) Notwithstanding any other provision of law, there is hereby established an account, within the Senate, to be known as the "Expense Allowance for the Secretary of the Senate, Sergeant at Arms and Doorkeeper of the Senate and Secretaries for the Majority and for the Minority, of the Senate" (hereinafter in this section referred to as the "Expense Allowance"). For each fiscal year (commencing with the fiscal year ending September 30, 1981) there shall be available from the Expense Allowance an expense allotment not to exceed $2,000 for each of the above specified officers. Amounts paid from the expense allotment of any such officer shall be paid to him only as reimbursement for actual expenses incurred by him and upon certification and documentation by him of such expenses. Amounts paid to any such officer pursuant to this section shall not be reported as income and shall not be allowed as a deduction under the Internal Revenue Code of 1954.

* * * * *

SEC. 139. (a) It is the sense of the Congress that the dollar limits on tax deductions for living expenses of Members of Congress while away from home shall be the same as such limits for businessmen and other private citizens.

(b)(1) The last sentence of section 162(a) of the Internal Revenue Code of 1954 is amended by striking out all after "home" and inserting in lieu thereof a period.

(2) Public Law 471, Eighty-second Congress, approved July 9, 1952 (66 Stat. 464) [1952-2 C.B. 357], is amended by striking out the proviso in the second paragraph of the matter under the heading "HOUSE OF REPRESENTATIVES, SALARIES, MILEAGE, AND EXPENSES OF MEMBERS" (66 Stat. 467; 2 U.S.C. 31c).

(3) The amendments made by this subsection shall apply to taxable years beginning after December 31, 1980.

* * * * *

Approved October 1, 1981.

Public Law 97-92 [1]

97th Congress, H.J. Res. 370

December 15, 1981

Joint Resolution making further continuing appropriations for the fiscal year 1982, and for other purposes.

* * * * *

SEC. 102. Appropriations and funds made available and authority granted pursuant to this joint resolution shall be available from December 15, 1981, and shall remain available until (a) enactment into law of an appropriation for any project or activity provided for in this joint resolution, or (b) enactment of the applicable appropriation Act by both Houses without any provision for such project or activity, or (c) March 31, 1982, whichever first occurs.

Subsection (c) of this section shall not reduce the availability of funds which would remain available beyond March 31, 1982, under the terms and conditions otherwise effective under this joint resolution.

* * * * *

SEC. 112.(a) None of the funds appropriated by this joint resolution may be used to—

(1) enforce Revenue Ruling 81-216 [1981-2 C.B. 21] or the proposed amendments to Income Tax Regulations sections 1.103-7 and 1.103-10 which were published in the Federal Register on October 8, 1981 [LR-264-81, 46 F.R. 50014; 1981-2 C.B. 772], or

(2) propose, promulgate, or enforce any ruling or regulation reaching the same result as, or a result similar to, such Revenue Ruling or Regulations, in connection with a qualified issue, or

(3) issue rulings or regulations which treat as exempt from taxation under section 103(b)(6) of the Internal Revenue Code of 1954 any interest earned on an obligation the proceeds of which are used for a disqualified facility.

(b)(1) For purposes of subsection (a), the term "qualified issue" means a single issue (whether or not part of a composite or multiple series of issues)—

(A) all of the obligations of which are directly or indirectly guaranteed or secured in whole or in part by—

(i) a State or political subdivision thereof or an instrumentality of either, or

(ii) in the case of an issue all of the proceeds of which are used for agricultural purposes, a qualified person (within the meaning of section 46(c)(8)(D) of the Internal Revenue Code of 1954 determined without regard to clauses (iii) and (iv) thereof), and

(B) none of the proceeds of which are used in connection with a disqualified facility or a facility with respect to which, at any time before January 1, 1987—

(i) any disqualified person used more than 5 percent of the facility, or

(ii) more than 25 percent of the facility is (in the aggregate) used by disqualified persons.

---

[1] This publication of the law is restricted to excerpts involving tax matters; House Reports No 97-223 and 97-260 are not published.

[1] This publication of the law is restricted to excerpts involving tax matters; House Report No. 97-372 is not published.

For purposes of subparagraph (B), use by a related person (within the meaning of section 103(b)(6)(C) of such Code) shall be treated as use by the disqualified person.

(2)(A) For purposes of paragraph (1), the term "disqualified person" means a person (other than an exempt person within the meaning of section 103(b)(3) of such Code) which has aggregate capital expenditures for any purpose which, for the period beginning October 1, 1979, and ending September 30, 1982, exceed $25,000,000.

(B) For purposes of determining the aggregate capital expenditures of any person under subparagraph (A), there shall be taken into account the capital expenditures of all persons which are—

(i) related persons (within the meaning of section 103(b)(6)(C) of such Code) with respect to such person; or

(ii) guarantors of any portion of the issue with respect to which a determination is being made under this subsection other than a guarantor which—

(I) is a State or a political subdivision thereof or an instrumentality of either,

(II) in the case of an issue all of the proceeds of which are used for agricultural purposes, a person described in paragraph (1)(A)(ii), or

(III) one or more financial institutions which are not related persons (within the meaning of section 103(b)(6)(C) of such Code to the user of the proceeds of the issue.

(C) For purposes of this paragraph, the term "capital expenditures" has the meaning given such term by section 103(b)(6)(D) of such Code, except that such term shall not include any amount paid or incurred by the taxpayer which constitutes a qualified research expense (within the meaning of section 44F(b) of such Code).

(c) For purposes of subsection (a) and subparagraph (b)(1)(B), a "disqualified facility" is any private or commercial—

(i) golf course,

(ii) country club,

(iii) massage parlor, or

(iv) tennis club.

(d) It is the sense of the Congress that after August 23, 1981, and until Congress enacts legislation which affects section 103(b)(6) of such Code, the Secretary of the Treasury or his delegate should in all cases enforce any ruling or regulation described in subsection (a)(1) or (2) in a manner consistent with the provisions of subsection (a).

SEC. 113. It is the sense of the Congress that the President of the United States should not include in his recommendations for revenue enhancements any recommendations which would have the effect of reducing Federal tax incentives for energy conservation or the development of renewable energy sources.

* * * * *

SEC. 133a. Notwithstanding section 102 of this joint resolution, section 139(b)(3) of Public Law 97-51 [page 306, this Bulletin] is amended by striking out "1981" and inserting in lieu thereof "1980".

* * * * *

Approved December 15, 1981.

Public Law 97-119 [1]

97th Congress, H.R. 5159

December 29, 1981

An Act to amend the Internal Revenue Code of 1954 to provide a temporary increase in the tax imposed on producers of coal, and for other purposes.

Be in enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

TITLE I—AMENDMENTS TO THE INTERNAL REVENUE CODE OF 1954

Subtitle A—Black Lung Benefits Revenue Provisions

SEC. 101 SHORT TITLE; AMENDMENT OF 1954 CODE.

(a) SHORT TITLE.—This subtitle may be cited as the "Black Lung Benefits Revenue Act of 1981".

(b) AMENDMENT OF 1954 CODE.—Except as otherwise expressly provided, whenever in this subtitle or subtitle B an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1954.

SEC. 102. TEMPORARY INCREASE IN AMOUNT OF TAX.

(a) GENERAL RULE.—Section 4121 (relating to tax on coal) is amended by adding at the end thereof the following new subsection:

"(e) TEMPORARY INCREASE IN AMOUNT OF TAX.—

"(1) IN GENERAL.—Effective with respect to sales after December 31, 1981, and before the temporary increase termination date—

"(A) subsection (a) shall be applied—

"(i) by substituting '$1' for '50 cents', and

"(ii) by substituting '50 cents' for '25 cents', and

"(B) subsection (b) shall be applied by substituting '4 percent' for '2 percent'.

"(2) TEMPORARY INCREASE TERMINATION DATE.—For purposes of paragraph (1), the temporary increase termination date is the earlier of—

"(A) January 1, 1996, or

"(B) the first January 1 after 1981 as of which there is—

"(i) no balance of repayable advances made to the Black Lung Disability Trust Fund, and

"(ii) no unpaid interest on such advances.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to sales after December 31, 1981.

SEC. 103. BLACK LUNG DISABILITY TRUST FUND.

(a) GENERAL RULE.—The Internal Revenue Code of 1954 is amended by adding at the end thereof the following new subtitle:

"Subtitle I—Trust Fund Code

"SEC. 9500. SHORT TITLE.

"This subtitle may be cited as the 'Trust Fund Code of 1981'.

---

[1] This publication of the law and House Report No. 97-406 Part 1, page 311 is restricted to excerpts involving tax matters.

"CHAPTER 98—TRUST FUND CODE

"Subchapter A. Establishment of Trust Funds.

"Subchapter B. General provisions.

"Subchapter A—Establishment of Trust Funds.

"Sec. 9501. Establishment of Black Lung Disability Trust Fund.

"SEC. 9501. ESTABLISHMENT OF BLACK LUNG DISABILITY TRUST FUND.

"(a) Creation of Trust Fund.—

"(1) In general.—There is established in the Treasury of the United States a trust fund to be known as the 'Black Lung Disability Trust Fund', consisting of such amounts as may be appropriated or credited to the Black Lung Disability Trust Fund.

"(2) Trustees.—The trustees of the Black Lung Disability Trust Fund shall be the Secretary of the Treasury, the Secretary of Labor, and the Secretary of Health and Human Services.

"(b) Transfer of Certain Taxes; Other Receipts.—

"(1) Transfer to black lung disability trust fund of amounts equivalent to certain taxes.—There are hereby appropriated to the Black Lung Disability Trust Fund amounts equivalent to the taxes received in the Treasury under section 4121 or subchapter B of chapter 42.

"(2) Certain repaid amounts, etc.—The following amounts shall be credited to the Black Lung Disability Trust Fund:

"(A) Amounts repaid or recovered under subsection (b) of section 424 of the Black Lung Benefits Act (including interest thereon).

"(B) Amounts paid as fines or penalties, or interest thereon, under section 423, 431, or 432 of the Black Lung Benefits Act.

"(C) Amounts paid into the Black Lung Disability Trust Fund by a trust described in section 501(c)(21).

"(c) Repayable Advances.—

"(1) Authorization.—There are authorized to be appropriated to the Black Lung Disability Trust Fund, as repayable advances, such sums as may from time to time be necessary to make the expenditures described in subsection (d).

"(2) Repayment with interest.—Repayable advances made to the Black Lung Disability Trust Fund shall be repaid, and interest on such advances shall be paid, to the general fund of the Treasury when the Secretary of the Treasury determines that moneys are available in the Black Lung Disability Trust Fund for such purposes.

"(3) Rate of interest.—Interest on advances made pursuant to this subsection shall be at a rate determined by the Secretary of the Treasury (as of the close of the calendar month preceding the month in which the advance is made) to be equal to the current average market yield on outstanding marketable obligations of the United States with remaining periods to maturity comparable to the anticipated period during which the advance will be outstanding.

"(d) Expenditures From Trust Fund.—Amounts in the Black Lung Disability Trust Fund shall be available, as provided by appropriation Acts, for—

"(1) the payment of benefits under section 422 of the Black Lung Benefits Act in any case in which the Secretary of Labor determines that—

"(A) the operator liable for the payment of such benefits—

"(i) has not commenced payment of such benefits within 30 days after the date of an initial determination of eligibility by the Secretary of Labor, or

"(ii) has not made a payment within 30 days after that payment is due,

except that, in the case of a claim filed on or after the date of the enactment of the Black Lung Benefits Revenue Act of 1981, amounts will be available under this subparagraph only for benefits accruing after the date of such initial determination, or

"(B) there is no operator who is liable for the payment of such benefits,

"(2) the payment of obligations incurred by the Secretary of Labor with respect to all claims of miners or their survivors in which the miner's last coal mine employment was before January 1, 1970,

"(3) the repayment into the Treasury of the United States of an amount equal to the sum of the amounts expended by the Secretary of Labor for claims under part C of the Black Lung Benefits Act which were paid before April 1, 1978, except that the Black Lung Disability Trust Fund shall not be obligated to pay or reimburse any such amounts which are attributable to periods of eligibility before January 1, 1974,

"(4) the repayment of, and the payment of interest on, repayable advances to the Black Lung Disability Trust Fund,

"(5) the payment of all expenses of administration on or after March 1, 1978—

"(A) incurred by the Department of Labor or the Department of Health and Human Services under part C of the Black Lung Benefits Act (other than under section 427(a) or 433), or

"(B) incurred by the Department of the Treasury in administering subchapter B of chapter 32 and in carrying out its responsibilities with respect to the Black Lung Disability Trust Fund,

"(6) the reimbursement of operators for amounts paid by such operators (other than as penalties or interest) before April 1, 1978, in satisfaction (in whole or in part) of claims of miners whose last employment in coal mines were terminated before January 1, 1970, and

"(7) the reimbursement of operators and insurers for amounts paid by such operators and insurers (other than amounts paid as penalties, interest, or attorney fees) at any time in satisfaction (in whole or in part) of any claim denied (within the meaning of section 402(i) of the Black Lung Benefits Act) before March 1, 1978, and which is or has been approved in accordance with the provisions of section 435 of the Black Lung Benefits Act.

For purposes of the preceding sentence, any reference to section 402(i), 422, or 435 of the Black Lung Benefits Act shall be treated as a reference to such section as in effect immediately after the enactment of this section.

"Subchapter B—General Provisions

"Sec. 9601. Transfer of amounts.

"Sec. 9602. Management of Trust Funds.

“SEC. 9601. TRANSFER OF AMOUNTS.

“The amounts appropriated by any section of subchapter A to any Trust Fund established by such subchapter shall be transferred at least monthly from the general fund of the Treasury to such Trust Fund on the basis of estimates made by the Secretary of the Treasury of the amounts referred to in such section. Proper adjustments shall be made in the amounts subsequently transferred to the extent prior estimates were in excess of or less than the amounts required to be transferred.

“SEC. 9602. MANAGEMENT OF TRUST FUNDS.

“(a) Report.—It shall be the duty of the Secretary of the Treasury to hold each Trust Fund established by subchapter A, and (after consultation with any other trustees of the Trust Fund) to report to the Congress each year on the financial condition and the results of the operations of each such Trust Fund during the preceding fiscal year and on its expected condition and operations during the next 5 fiscal years. Such report shall be printed as a House document of the session of the Congress to which the report is made.

“(b) Investment.—

“(1) In general.—It shall be the duty of the Secretary of the Treasury to invest such portion of any Trust Fund established by subchapter A as is not, in his judgment, required to meet current withdrawals. Such investments may be made only in interest-bearing obligations of the United States. For such purpose, such obligations may be acquired—

“(A) on original issue at the issue price, or

“(B) by purchase of outstanding obligations at the market price.

“(2) Sale of obligations..—Any obligation acquired by a Trust Fund established by subchapter A may be sold by the Secretary of the Treasury at the market price.

“(3) Interest on certain proceeds.—The interest on, and the proceeds from the sale or redemption of, any obligations held in a Trust Fund established by subchapter A shall be credited to and form a part of the Trust Fund”.

(b) Repeal of Subsections (a), (b), and (c) of Section 3 of the Black Lung Benefits Revenue Act of 1977.—Subsections (a), (b), and (c) of section 3 of the Black Lung Benefits Revenue Act of 1977 are hereby repealed.

(c) Clerical Amendments.—

(1) Clause (iii) of section 501(c)(21)(B) is amended by striking out “established under section 3 of the Black Lung Benefits Revenue Act of 1977” and inserting in lieu thereof “established under section 9501”.

(2) The table of subtitles for such Code is amended by adding at the end thereof of the following new item:

“Subtitle I. Trust Fund Code.”.

(d) Effective Date.—

(1) In general.—The amendments made by this section shall take effect on January 1, 1982. Section 9501(c)(3) of the Internal Revenue Code of 1954 (as added by subsection (a)) shall only apply to advances made after December 31, 1981.

(2) Savings provisions.—The Black Lung Disability Trust Fund established by the amendments made by this section shall be treated for all purposes of law as the continuation of the Black Lung Disability Trust Fund established by section 3 of the Black Lung Benefits Revenue Act of 1977. Any reference in any law to the Black Lung Disability Trust Fund established by such section 3 shall be deemed to include a reference to the Black Lung Disability Trust Fund established by the amendments made by this section.

SEC.104. AMENDMENTS TO SECTION 424 OF THE BLACK LUNG BENEFITS ACT.

(a) Interest on Operator Liabilities.—

(1) Rate of interest.—Subsection (b) of section 424 of the Black Lung Benefits Act is amended by adding at the end thereof the following new paragraph:

“(5) The rate of interest under this subsection—

“(A) for any period during calendar year 1982, shall be 15 percent, and

“(B) for any period after calendar year 1982, shall be the rate established by section 6621 of the Internal Revenue Code of 1954 which is in effect for such period.”.

(2) Clarifying amendment.—The first sentence of section 424(b)(1) of the Black Lung Benefits Act is amended by inserting “plus interest thereon” after “attributed to him”.

(3) Effective date.—The amendment made by paragraph (1) shall take effect on January 1, 1982, and shall apply to amounts outstanding on such date or arising thereafter.

(1) Section 402(h) of the Black Lung Benefits Act is amended to read as follows:

“(h) The term ‘fund’ means the Black Lung Disability Trust Fund established by section 9501 of the Internal Revenue Code of 1954.”.

(2) Section 415(a)(1) of the Black Lung Benefits Act is amended by striking “section 424 of this title” and inserting in lieu thereof “section 9501(d) of the Internal Revenue Code of 1954”.

(3) Section 422(a) of the Black Lung Benefits Act is amended by striking “section 424” and inserting in lieu thereof “section 9501(d) of the Internal Revenue Code of 1954”.

(4) Section 422(i)(4) of the Black Lung Benefits Act is amended by striking “sectin 424” and inserting in lieu thereof “section 9501(d) of the Internal Revenue Code of 1954”.

(5) Section 422(j) of the Black Lung Benefits Act is amended by striking “section 424 shall” and inserting in lieu thereof “section 9501 of the Internal Revenue Code of 1954 shall”; and by striking “section 424(a)(1)” and inserting in lieu thereof “section 9501(d)(1) of the Internal Revenue Code of 1954”.

(6) Section 424(a) of the Black Lung Benefits Act is amended to read as follows:

“(a) For purposes of this section, the term ‘fund’ has the meaning set forth in section 402(h).”.

Subtitle B—Miscellaneous Revenue Amendments

SEC. 111. ADDITIONAL 2-YEAR DELAY IN APPLICATION OF THE NET OPERATING LOSS RULES ADDED BY THE TAX REFORM ACT OF 1976.

Paragraphs (2) and (3) of section 806(g) of the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol.

1)1, 81] (relating to effective dates for the amendments to sections 382 and 383 of the Internal Revenue Code of 1954) are amended by striking out "1982" each place it appears and inserting in lieu thereof "1984".

SEC. 112. INFORMATION RETURNS WITH RESPECT TO SAFE HARBOR LEASES.

(a) REQUIREMENT OF RETURN.—

(1) IN GENERAL.—Except as provided in paragraph (2), paragraph (8) of section 168(f) of the Internal Revenue Code of 1954 (relating to special rule for leases) shall not apply with respect to an agreement unless a return, signed by the lessor and lessee and containing the information required to be included in the return pursuant to subsection (b), has been filed with the Internal Revenue Service not later than the 30th day after the date on which the agreement is executed.

(2) SPECIAL RULES FOR AGREEMENTS EXECUTED BEFORE JANUARY 1, 1982.—

(A) IN GENERAL.—In the case of an agreement executed before January 1, 1982, such agreement shall cease on February 1, 1982, to be treated as a lease under section 168(f)(8) unless a return, signed by the lessor and containing the information required to be included in subsection (b), has been filed with the Internal Revenue Service not later than January 31, 1982.

(B) FILING BY LESSEE.—If the lessor does not file a return under subparagraph (A), the return requirement under subparagraph (A) shall be satisfied if such return is filed by the lessee before January 31, 1982.

(3) CERTAIN FAILURE TO FILE.—If—

(A) a lessor or lessee fails to file any return within the time prescribed by this subsection, and

(B) such failure is shown to be due to reasonable cause and not due to willful neglect,

the lessor or lessee shall be treated as having filed a timely return if a return is filed within a reasonable time after the failure is ascertained.

(b) INFORMATION REQUIRED.—The information required to be included in the return pursuant to this subsection is as follows:

(1) The name, address, and taxpayer identifying number of the lessor and the lessee (and parent company if a consolidated return is filed);

(2) The district director's office with which the income tax returns of the lessor and lessee are filed;

(3) A description of each individual property with respect to which the election is made;

(4) The date on which the lessee places the property in service, the date on which the lease begins and the term of the lease;

(5) The recovery property class and the ADR midpoint life of the leased property;

(6) The payment terms between the parties to the lease transaction;

(7) Whether the ACRS deductions and the investment tax credit are allowable to the same taxpayer;

(8) The aggregate amount paid to outside parties to arrange or carry out the transaction;

(9) For the lessor only: the unadjusted basis of the property as defined in section 168(d)(1);

(10) For the lessor only: if the lessor is a partnership or a grantor trust, the name, address, and taxpayer identifying number of the partners or the beneficiaries, and the district director's office with which the income tax return of each partner or beneficiary is filed; and

(11) Such other information as may be required by the return or its instructions.

Paragraph (8) shall not apply with respect to any person for any calendar year if it is reasonable to estimate that the aggregate adjusted basis of the property of such person which will be subject to subsection (a) for such year is $1,000,000 or less.

(c) COORDINATION WITH OTHER INFORMATION REQUIREMENTS.—In the case of agreements executed after December 31, 1982, to the extent provided in regulations prescribed by the Secretary of the Treasury or his delegate, the provisions of this section shall be modified to coordinate such provisions with the other information requirements of the Internal Revenue Code of 1954.

SEC 113. EXPENSES IN CONNECTION WITH BUSINESS USE OF A HOME, ETC.

(a) RENTAL TO FAMILY MEMBERS AND SHARED EQUITY AGREEMENTS PERMITTED.—

(1) IN GENERAL.—Subsection (d) of section 280A (relating to disallowance of certain expenses in connection with business use of home, rental of vacation homes, etc.) is amended by redesignating paragraph (3) as paragraph (4) and by inserting after paragraph (2) the following new paragraph:

"(3) RENTAL TO FAMILY MEMBER, ETC., FOR USE AS PRINCIPAL RESIDENCE.—

"(A) IN GENERAL.—A taxpayer shall not be treated as using a dwelling unit for personal purposes by reason of a rental arrangement for any period if for such period such dwelling unit is rented, at a fair rental, to any person for use as such person's principal residence.

"(B) SPECIAL RULES FOR RENTAL TO PERSON HAVING INTEREST IN UNIT.—

"(i) RENTAL MUST BE PURSUANT TO SHARED EQUITY FINANCING AGREEMENT.—Subparagraph (A) shall apply to a rental to a person who has an interest in the dwelling unit only if such rental is pursuant to a shared equity financing agreement.

"(ii) DETERMINATION OF FAIR RENTAL.—In the case of a rental pursuant to a shared equity financing agreement, fair rental shall be determined as of the time the agreement is entered into and by taking into account the occupant's qualified ownership interest.

"(C) SHARED EQUITY FINANCING AGREEMENT.—For purposes of this paragraph, the term 'shared equity financing agreement' means an agreement under which—

"(i) 2 or more persons acquire qualified ownership interests in a dwelling unit, and

"(ii) the person (or persons) holding 1 or more of such interests—

"(I) is entitled to occupy the dwelling unit for use as a principal residence, and

"(II) is required to pay rent to 1 or more other persons holding qualified ownership interests in the dwelling unit.

"(D) Qualified ownership interest.—For purposes of this paragraph, the term 'qualified ownership interest' means an undivided interest for more than 50 years in the entire dwelling unit and appurtenant land being acquired in the transaction to which the shared equity financing agreement relates.".

(2) Definition of qualified rental period.—Subparagraph (B) of section 280(A)(d)(4) (defining qualified rental period), as redesignated by paragraph (1), is amended by striking out "to a person other than a member of the family (as defined in section 267(c)(4)) of the taxpayer".

(b) Treatment of Expenses While Away From Home in Pursuit of Trade or Business.—

"(1) In general.—Subsection (f) of section 280A is amended by adding at the end thereof the following new paragraph:

"(4) Coordination with section 162(a)(2), etc.—

"(A) In general.—Nothing in this section shall be construed to disallow any deduction allowable under section 162(a)(2) (or any deduction which meets the tests of section 162(a)(2) but is allowable under another provision of this title) by reason of the taxpayer's being away from home in the pursuit of a trade or business (other than the trade or business of renting dwelling units).

"(B) Limitation.—The Secretary shall prescribe amounts deductible (without substantiation) pursuant to the last sentence of section 162(a), but nothing in subparagraph (A) or any other provision of this title shall permit such a deduction for any taxable year of amounts in excess of the amounts determined to be appropriate under the circumstances.".

(c) Principal Place of Business Applies to Any Trade or Business.—Subparagraph (A) of section 280A(c)(1) (relating to certain business use) is amended to read as follows:

"(A) the principal place of business for any trade or business of the taxpayer.".

(d) Repair and Maintenance of Dwelling Unit.—The last sentence of paragraph (2) of section 280A(d) (relating to personal use of residence) is amended by inserting ", except that if the taxpayer is engaged in repair and maintenance on a substantially full time basis for any day, such authority shall not allow the Secretary to treat a dwelling unit as being used for personal use by the taxpayer on such day merely because other individuals who are on the premises on such day are not so engaged" after "paragraph".

(e) Effective Date.—The amendments made by this section shall apply to taxable years beginning after December 31, 1975, except that in the case of taxable years beginning after December 31, 1975, and before January 1, 1980, the amendment made by this section shall apply only to taxable years for which, on the date of the enactment of this Act, the making of a refund, or the assessment of a deficiency, was not barred by law or any rule of law.

* * * * *

Approved December 29, 1981.

House of Representatives Report No. 97-406 Part 1

1st Session

[Bracketed numerals indicate official report page numbers]

BLACK LUNG BENEFITS REVENUE ACT OF 1981

December 14, 1981

Mr. Rostenkowski, from the Committee on Ways and Means, submitted the following Report to accompany H.R. 5159.[1]

The Committee on Ways and Means, to whom was referred the bill (H.R. 5159) to amend the Internal Revenue Code of 1954 to provide a temporary increase in the tax imposed on producers of coal, and for other purposes, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

[2] I. SUMMARY

Under present law, an excise tax is imposed on the coal producer's sale or use of coal, (except lignite) equal to 50 cents per ton for underground-mined coal and 25 cents per ton for surface-mined coal. However, the tax cannot exceed 2 percent of the price for which the coal is sold. Amounts equal to the revenues of the excise tax on coal are automatically appropriated to the Black Lung Disability Trust Fund, as established by the Black Lung Benefits Revenue Act of 1977 [Pub. L. 95-227, 1978-1 C.B. 494].

Under the bill, the coal excise tax is increased on January 1, 1982, to one dollar per ton for underground-mined coal and 50 cents per ton for surface-mined coal, with a cap of 4 percent of the price for which the coal is sold. The tax will revert to present law levels by January 1, 1996, or, if earlier, when the trust fund has repair all advances and interest from the general fund of the Treasury.

In addition, the bill modifies the computation of interest on certain amounts owed to or by the trust fund. The bill amends the obligations of the fund to include certain claims that had been previously denied and subsequently approved and to exclude payments of certain retroactive lump sum benefits. Finally, the bill transfers provisions which establish the Black Lung

---

[1] Public Law 97-119, page 307.

Disability Trust Fund to the International Revenue Code.

[3] II. EXPLANATION OF THE BILL

PRESENT LAW

EXCISE TAX ON COAL

Under present law, a manufacturers excise tax is imposed on domestically mined coal (other than lignite) which is sold or used by the producer (Code secs. 4121 and 4218). The rate of tax is the lesser of (1) 50 cents per ton for coal from underground mines and 25 cents per ton for coal from surface mines or (2) 2 percent of the price for which the coal is sold.

Amounts equal to the revenues from this excise tax (plus any revenues from the penalty tax on taxable expenditures from a coal mine operator self-insurance trust, described below) are automatically appropriated to the Black Lung Disability Trust Fund.

BLACK LUNG DISABILITY TRUST FUND

The Black Lung Disability Trust Fund was created in 1978 pursuant to the Black Lung Benefits Revenue Act of 1977 (Public Law 95-227). The trustees of the fund are the Secretary of the Treasury, the Secretary of Labor, and the Secretary of Health and Human Services. The Secretary of the Treasury is the managing trustee.

Amounts in the fund are available pursuant to appropriation acts to pay for benefits to certain coal miners who are totally disabled by pneumoconiosis ("black lung" disease) arising out of coal mine employment and to their survivors. Generally, the fund is required to pay benefits with respect to claims in which the miner's last coal mine employment was before January 1, 1970, provided the claim is filed after June 30, 1973. Also, the fund pays benefits if there is no coal mine operator among the miner's employers who is responsible for paying such benefits (a "responsible operator") or if the responsible operator is in default. When an operator is determined to be responsible for the payment of benefits which in fact have been paid out of the fund, then the operator is obligated to reimburse the fund for those amounts plus interest computed at the rate of 6 percent per annum.

When receipts of the trust fund are less than its expenditures, advances are appropriated from the general fund of the Treasury to the trust fund. These advances are repayable, and interest on such advances is charged at a rate equal to the average rate of interest, computed as of the end of the calendar month preceding the month in which the advance is made, borne by all marketable interest-bearing obligations of the United States then forming a part of the public debt.

The expenses of the Department of Labor and the administrative expenses of the Department of Health and Human Services for the claims program financed through the trust fund are paid out of trust [4] monies. The fund also bears the cost of its own administration as well as the costs of administering the collection of the excise tax on coal.

COAL MINE OPERATORS' SELF-INSURANCE TRUSTS

Present law provides that a responsible operator may fund its liability for black lung benefits through deductible contributions to a qualified tax-exempt trust (sec. 501(c)(21)). To qualify, this trust must be established for the sole purpose of satisfying the operator's liability under Black Lung Acts, paying premiums for insurance exclusively covering such liability, and paying administrative expenses of the trust. Monies of a qualified trust that are not needed to satisfy current liability may be invested only in government securities or insured savings deposits.

Misuse of a trust due to self-dealing (sec. 4951), expenditures for an improper purpose (sec. 4952) or excessive contributions to the trust (sec. 4953), triggers certain excise taxes. Amounts collected under these provisions, which in the past have been very small, are deposited in the general fund, except that amounts equal to the taxes collected under the operation of section 4952 are appropriated t
Black Lung Disability Trust Fun

CONDITION OF THE BLAC LUNG DISABILITY TRUST FUND

For fiscal year 1981, it is esti
that the fund expended $644 m
for benefit payments net of reim
ments, $36 million for administ
expenses and $109 million for int
or a total expenditure of $789 mi
Coal excise tax collections for
year 1981 are estimated to have
$237 million, producing a defi
$552 million for the year. Annua
cits of the fund were $19 million
cal year 1978, $401 million in
and $536 million in 1980. Thu
cumulative deficit of the fund a
close of fiscal year 1981 is estima
be approximately $1.5 billion.

REASONS FOR CHANGE

The committee is concerned
the Black Lung Disability Trust
has experienced a deficit in every
of its operation and that these de
have been increasing. The comm
believes that several amendment
required to reduce and ultimate
eliminate the deficit of the fund.

As the fund is financed princip
by revenues from the excise ta
coal, the committee believes that
tax should be increased tempor
until the fund has repaid its adva
from the general fund of the Trea
In addition, the committee bel
that the interest rate charged
amounts which a coal mine opera
required to reimburse to the
should be modified to reflect mor
curately the cost of borrowing mo
so that any decision to contest a c
or to prolong the time taken for re
ing a settlement is not biased by a
cation of a below market interest
Similarly, the committee believes
the interest rate charged on a re
able advance from the Trea
should be modified to reflect mor
curately the anticipated term of
advance.

[5] The committee believes

amendments to the obligations of the fund are needed in order to distribute more equitably the costs of certain claims awarded pursuant to provisions of the Black Lung Benefits Reform Act of 1977 and to reduce expenditures from the fund in cases of contested claims.

The committee believes that amendments are needed to facilitate the exercise of its responsibilities with respect to the Black Lung Disability Trust Fund. Specifically, the committee believes that provisions which establish the fund and relate to its management should be transferred to the Internal Revenue Code, that these provisions should be standardized and updated to conform to the language of other trust funds, and that the financing of the fund should be considered in connection with any expansion of the expenditure purposes of the fund.

EXPLANATION OF PROVISIONS

EXCISE TAX ON COAL

Under the bill, the manufacturers excise tax on coal is increased to the lesser of (1) $1 per ton for coal from underground mines and 50 cents per ton for coal from surface mines or (2) 4 percent of the price for which the coal is sold. These rates will revert to present law rates on January 1, 1996, or, if earlier, on the first January 1 after 1981 as of which there is no balance of repayable advances made to the Black Lung Disability Trust Fund and no unpaid interest on such balances.

The bill also appropriates to the Black Lung Disability Trust Fund amounts equal to the excise taxes collected under the operation of sections 4951 (relating to self-dealing) and 4953 (relating to excess contributions), in addition to the amounts appropriated under present law under the operation of section 4952 (relating to taxable expenditures from a coal mine

OBLIGATIONS OF THE TRUST FUND

Under the bill, certain claims which had been assigned to individual coal operators will be transferred to the Black Lung Disability Trust Fund. In general, these are claims which had been denied prior to March 1, 1978, but which had been reviewed and approved under the liberalized eligibility criteria and evidentiary standards of the Black Lung Benefits Reform Act of 1977 (Public Law 95-239). It is expected that the definition of such claims will be established, consistent with that definition contained in S. 1922 (97th Congress, 1st Session), in a new section 402(i) of the Black Lung Benefits Act.

In addition, for claims filed after the date of enactment, the bill eliminates the present law obligation of the fund to pay retroactive lump sum benefits when an initial determination of eligibility is made but the responsible operator contests the award. However, the bill does not affect the present law obligation of the fund to pay benefits that accrue after this initial determination.

The bill provides that fund monies will be available to meet obligations incurred under sections (402(i), 422 and 435 of the Black Lung [6] Benefits Act, as such sections are in effect immediately after the enactment of this bill. This provision requires that the expenditure purposes of the fund be conformed to reflect substantive changes relating to eligibility and benefits that may be made by other appropriate committees in the future, before the fund will make payment for any such amended purpose. This provision is to ensure that the fund will have sufficient revenue to satisfy obligations arising from amendments made after enactment of this bill.

METHODS OF COMPUTING INTEREST

Under the bill, interest for any period charged by the Black Lung Disability Trust Fund on amounts which the fund has paid and for which a mine operator is liable generally will be computed at the interest rate that applies for the period to tax deficiencies and overpayments under section 6621. However, for any period during calendar year 1982, this interest rate will be 15 percent.

In addition, the bill amends the method for computing interest payable by the fund to the general fund on repayable advances. Under the bill, the interest rate that will be applied is a rate determined by the Secretary of the Treasury (as of the close of the calendar month preceding the month in which the advance is made) to be equal to the current average market yield on outstanding marketable obligations of the United States with remaining periods to maturity comparable to the anticipated period during which the advance will be outstanding.

TRANSFER OF TRUST FUND PROVISIONS TO THE INTERNAL REVENUE CODE

Under the bill, provisions which establish the Black Lung Disability Trust Fund and relate to its management and provisions by which amounts appropriated to the fund are transferred from the general fund of the Treasury will become provisions of the Internal Revenue Code of 1954. The Black Lung Disability Trust Fund established by the bill will be treated for all purposes of law as the continuation of the Black Lung Disability Trust Fund established by section 3 of the Black Lung Benefits Revenue Act of 1977.

The bill will standardize and update provisions of the Black Lung Disability Trust Fund to conform to the language of other trust funds. The committee intends no substantive effect in deleting archaic language in present law, such as language which provides that the fund remain available without fiscal year limitation. In conforming language relating to the annual report of the Secretary of the Treasury to Congress on the condition of the fund, the committee does not intend to preclude inclusion in such annual report of any items of special pertinence to the Black Lung Disability Trust Fund (such as recommendations of the trustees with respect to changes in revenues to or expenditures from the fund).

EFFECTIVE DATES

In general, the provisions of the bill are effective on January 1, 1982. Thus, the increased excise tax on coal is effective for sales or use by a coal producer after December 31, 1981. The modified method for computing interest payable on repayable advances applies to advances made after December 31, 1981. The modified method for computing interest on operator liabilities is effective on January 1, 1982, and applies to amounts outstanding on such date or arising thereafter.

* * * * *

Public Law 97-123 [1]

97th Congress, H.R. 4331

An act to amend the Omnibus Reconciliation Act of 1981 [Pub. L. 97-35, 1981-2 C.B. 528] to restore minimum benefits under the Social Security Act.

* * * * *

EXTENSION OF COVERAGE TO FIRST SIX MONTHS OF SICK PAY

SEC. 3. (a) Clause (2) of section 209(b) of the Social Security Act is amended by inserting immediately after "sickness or accident disability" the following: "(but, in the case of payments made to an employee or any of his dependents, this clause shall exclude from the term 'wages' only payments which are received under a workmen's compensation law)".

(b)(1) Subparagraph (B) of section 3121(a)(2) of the Internal Revenue Code of 1954 (defining wages for purposes of the Federal Insurance Contributions Act) is amended to read as follows:

"(B) sickness or accident disability (but, in the case of payments made to an employee or any of his dependents, this subparagraph shall exclude from the term 'wages' only payments which are received under a workmen's compensation law), or".

(2) Section 3121(a) of such Code is further amended by adding at the end thereof (after and below paragraph (18)) the following new sentence:

"Except as otherwise provided in regulations prescribed by the Secretary, any third party which makes a payment included in wages solely by reason of the parenthetical matter contained in subparagraph (B) of paragraph (2) shall be treated for purposes of this chapter and chapter 22 as the employer with respect to such wages."

(c) Subsection (e) of section 3231 of such Code (defining compensation for purposes of the Railroad Retirement Tax Act) is amended by adding at the end thereof the following new paragraph:

"(4)(A) For purposes of applying sections 3201(b) and 3221(b) (and so much of section 3211(a) as relates to the rates of the taxes imposed by sections 3101 and 3111), in the case of payments made to an employee or any of his dependents on account of sickness or accident disability, clause (i) of the second sentence of paragraph (1) shall exclude from the term 'compensation' only—

"(i) payments which are received under a workmen's compensation law, and

"(ii) benefits received under the Railroad Retirement Act of 1974. [Pub. L. 93-445, 1974-2 C.B. 440]

"(B) Notwithstanding any other provision of law, for purposes of the sections specified in subparagraph (A), the term 'compensation' shall include benefits paid under section 2(a) of the Railroad Unemployment Insurance Act for days of sickness, except to the extent that such sickness (as determined in accordance with standards prescribed by the Railroad Retirement Board) is the result of on-the-job injury.

"(C) Under regulations prescribed by the Secretary, subparagraphs (A) and (B) shall not apply to payments made after the expiration of a 6-month period comparable to the 6-month period described in section 3121(a)(4).

"(D) Except as otherwise provided in regulations prescribed by the Secretary, any third party which makes a payment included in compensation
solely by reason of subparagraph (
or (B) shall be treated for purposes
this chapter as the employer with r
spect to such compensation."

(d)(1) The regulations prescribe
under the last sentence of sectio
3121(a) of the Internal Revenue Co
of 1954, and the regulations pr
scribed under subparagraph (D)
section 3231(e)(4) of such Code, sha
provide procedures under which,
(with respect to any employee) t
third party promptly—

(A) withholds the employee porti
of the taxes involved,

(B) deposits such portion und
section 6302 of such Code, and

(C) notifies the employer of t
amount of the wages or compensati
involved,

the employer (and not the third par
shall be liable for the employer porti
of the taxes involved and for meeti
the requirements of section 6051
such Code (relating to receipts for e
ployees) with respects to the wages
compensation involved.

(2) For purposes of paragraph (1)

(A) the term "employer" means t
employer for whom services are n
mally rendered,

(B) the term "taxes involve
means, in the case of any employe
the taxes under chapters 21 and
which are payable solely by reason
the parenthetical matter contained
subparagraph (B) of section 3121(a)
of such Code, or solely by reason
paragraph (4) of section 3231(e)
such Code, and

(C) the term "wages or compens
tion involved" means, in the case
any employee, wages or compensati
with respect to which taxes describ
in subparagraph (B) are imposed.

(e) For purposes of applying secti
209 of the Social Security Act, secti
3121(a) of the Internal Revenue Co
of 1954, and section 3231(e) of su
Code with respect to the parentheti
matter contained in section 209(b)
of the Social Security Act or secti
3121(a)(2)(B) of the Internal Reven
Code of 1954, or with respect to s
tion 3231(e)(4) of such Code (as
case may be), payments under a St
temporary disability law shall
treated as remuneration for service.

(f) Notwithstanding any ot
provision of law, no penalties or

---

[1] This publication of the law and Conference Report No. 97-409, page 315 is restricted to excerpts involving tax matters.

terest shall be assessed on account of any failure to make timely payment of taxes, imposed by section 3101, 3111, 3201(b), 3211, or 3221(b) of the Internal Revenue Code of 1954 with respect to payments made for the period beginning January 1, 1982, and ending June 30, 1982, to the extent that such taxes are attributable to this section (or the amendments made by this section) and that such failure is due to reasonable cause and not to willful neglect.

(g)(1) Except as provided in paragraph (2), this section (and the amendments made by this section) shall apply to remuneration paid after December 31, 1981.

(2) This section (and the amendments made by this section) shall not apply with respect to any payment made by a third party to an employee pursuant to a contractual relationship of an employer with such third party entered into before December 14, 1981, if—

(A) coverage by such third party for the group in which such employee falls ceases before March 1, 1982, and

(B) no payment by such third party is made to such employee under such relationship after February 28, 1982.

* * * * *

Approved: December 29, 1981.

Conference Report No. 97-409 [1]

1st Session

[Bracketed numerals indicate official report page numbers]

SOCIAL SECURITY AMENDMENTS OF 1981

December 14, 1981:

MR. ROSTENKOWSKI, from the committee of conference, submitted the following Conference Report to accompany H.R. 4331.

* * * * *

[12] EXTENSION OF COVERAGE TO FIRST SIX MONTHS OF SICK PAY—SECTION 3

Present law.—Payments made to or on behalf of an employee of a private employer on account of sickness or accident disability are subject to social security taxes and are treated as covered earnings *unless* they are either: (1) paid under a qualified plan or system; or (2) paid after the employee has not worked for the employer for more than six months. A qualified plan or system is one that applies to the employees of a firm generally or to a class or classes of employees. The existence of a plan or system is shown if the plan or system is in writing or is otherwise made known to employees (for example, through the medium of a bulletin board notice or the long and established practice of the employer). Other indications of the existence of a plan or system include, but are not limited to, contractual references to a plan or system, employer contributions to a plan, or segregated accounts for the payment of benefits.

With respect to railroad employment, the Railroad Retirement Tax Act, sec. 3201 et seq. of the Internal Revenue Code, excludes from taxable compensation the amount of any payment (including any amount paid by an employer for insurance or annuities) made to, or on behalf of, an employee or any of his dependents under a plan or system, on account of sickness or accident disability.

Under the Railroad Unemployment Insurance Act (sec. 2(a)) certain daily benefits are paid from the railroad unemployment insurance account for qualified employees for each day of sickness after the fourth consecutive day of sickness in a period of continuing sickness. In general, the daily benefit rate for such sickness is an amount equal to sixty percent of the employee's daily rate of compensation in a base year, but not less than $12.70 nor in excess of $25.00 per day. The maximum number of days of sickness within a benefit year for which benefits may be paid to an employee is one hundred and thirty (26 weeks). Under present law these sickness and disability benefits are not taxable compensation for railroad retirement tax purposes.

House bill.—No provision.

Senate amendment.—Section 104 of the amendment would remove the exclusion of certain sick pay received under a plan or system during the first six months the employee is off work. However, payments made by an insurance company would still be exempt unless the company is owned, to a substantial extent, by the employer, or the insurance company has an administrative-services-only contract with the employer under which the insurance company is reimbursed for sick payments actually made plus administrative expenses and profits. In addition, payments required by a workmen's compensation or temporary disability insurance law would continue to be exempt. This provision would be ef- [13] fective for sick payments made in January 1982 and thereafter. The treatment of payments made to an employee more than six months after the employee last worked would be unchanged from current law. Under the Senate amendment, sick payments made to employees covered by the railroad retirement system and sick pay benefits received under the Railroad Unemployment Insurance Act would continue to be exempt from railroad retirement employment taxes.

Conference agreement.—The conference agreement follows the Senate amendment extending coverage to certain forms of sick pay. In addition, the conference agreement would include in the definition of wages both for tax and coverage purposes, payments made under a sick pay plan to an employee or any of his dependents by a third party on account of the employee's illness. However, in the case where an employee has contributed to such plan, "wages" or "compensation" shall not include that portion of such payments attributable to the employee's contributions. It is the view of the conferees that such amounts are properly excludable in that they do not constitute remuneration for employment but rather represent a return on the premium contributions made by the employee. The conferees intend that rules similar to those provided in sec. 105 of the Internal Revenue Code (and regulations promulgated thereunder) shall apply in this instance. Payments which are received under a workmen's compensation law and those paid to an employee by either the employer or a third party more than six months after the employee last worked would continue to be excluded from the definition of wages, as under present law.

---

[1] Public Law 97-123, page 314.

The conference agreement also provides that any third party (for example, an insurance company) that makes a payment, which is included in wages solely by reason of this provision, shall be treated as the employer with respect to such wages for purposes of social security and railroad retirement employment taxes. Thus, a third party payor will be responsible for the withholding of employee FICA taxes on wages up to the applicable maximum taxable wage base and for the remittance and timely deposit (as otherwise provided by law) of FICA taxes. However, the conference agreement establishes s specific statutory exception to this rule: the liability for the employer share of the FICA taxes will shift from the third party to the actual employer as soon as the third party payor has deposited the withheld employee taxes and notified the employer of the amount of sick pay made to the employee.

The conference agreement mandates the development of regulations which shall provide procedures under which, if the third party payor promptly withholds the employee portion of the taxes, deposits those taxes pursuant to the rules under section 6302 of the Code, and notifies the employer for whom services are usually rendered, of the payment, the employer (and not the third party payor) shall be liable for the employer portion of tax and for providing written statements and other reporting requirements under Code section 6051. It is the intention of the conferees that these regulations provide that third party payors withhold the employee portion of the tax as payments are made and deposit such withheld amounts under the applicable schedule authorized by Code section 6302 (including information reports such as Form 941 and related forms) as if these amounts were paid out of the third party payor's [14] own payroll. Further, the provision adopted by the conferees requires simultaneous notification of the employer of the amount of compensation paid to each employee. If these conditions are met, the liability for the employer portion of the payroll tax shifts from the party making the payments to the employer for whom services are normally rendered. Upon the employer's receipt of the notification of the payment made by the third party, such employer must deposit the appropriate employer taxes as if these payments were made out of his own payroll on that date. The conferees intend that the implementing regulations shall be promptly issued and that, having met the conditions specified in sec. 3(d), they will be relieved of the liability.

As a result, FICA and railroad retirement employment taxes on combined amounts in excess of the maximum taxable wage base could be withheld from employees and paid by employers. Under section 6413(c) of the Internal Revenue Code, employees who experience such overwithholding are eligible to receive refunds. The conferees expect that the Secretary will attempt to design procedures whereby employers and third party payors can avoid withholding on combined amounts in excess of the maximum taxable wage base (both for FICA and railroad retirement taxes) and will implement these procedures by regulation.

The conference agreement provides that, notwithstanding any other provision of law (including certain payments made under the Railroad Unemployment Insurance Act), compensation for purposes of the Railroad Retirement Tax Act shall include all payments made to an employee or any of his dependents on account of sickness or accident disability during the first six months the employee is off work except: payments which are received under a workmen's compensation law; payments which are received under The Railroad Retirement Act of 1974; or benefits which are paid under section 2(a) of the Railroad Unemployment Insurance Act for days of sickness to the extent that such sickness is the result of on-the-job injury (as determined in accordance with standards prescribed by the Railroad Retirement Board).

In addition, the conference agreement provides that, for purposes of the taxes imposed by this provision, payments made under a state temporary disability insurance law shall be treated as remuneration for service.

Under the conference agreement, no penalties or interest shall be assessed for failure to make timely payments of taxes with respect to payments of sick pay made between January 1, 1982 and June 30, 1982 and which are imposed as a result of amendments made by this section, to the extent that such failure is due to willful neglect and such taxes are paid on or before June 30, 1982.

Finally, the conference agreement provides generally that the amendments made by this section shall apply to remuneration paid after December 31, 1981. However, these amendments shall not apply to any third party payment made to an employee pursuant to a contractual relationship of an employer with such third party which is entered into before December 14, 1981, if the third party's coverage for that employee's group ceases before February 28, 1982 and no third party payment is made to such employee under that contract after February 28, 1982. Since such payments would not [15] be considered remuneration for purposes of these taxes, no employment taxes would be levied on such payments.

* * * * *

Public Law 97-164 [1]

97th Congress, H.R. 4482

An act to establish a United States Court of Appeals for the Federal Circuit, to establish a United States Claims Court, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Federal Courts Improvement Act of 1982".

TITLE I—UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT AND UNITED STATES CLAIMS COURT

PART A—ORGANIZATION, STRUCTURE, AND JURISDICTION

---

[1] This publication of the law and House Report 97-312, page 320, is restricted to excerpts involving tax matters; Senate Report 97-275 is not published.

NUMBER AND COMPOSITION OF CIRCUITS

SEC. 101. Section 41 of title 28, United States Code, as amended by the Fifth Circuit Court of Appeals Reorganization Act of 1980 (Public Law 96-452; 94 Stat. 1994), is amended by striking out "twelve" and inserting in lieu thereof "thirteen" and by adding at the end thereof the following:

"Federal . . . All Federal judicial districts.".

* * * * *

ORGANIZATION OF UNITED STATES CLAIMS COURT

SEC. 105. (a) Chapter 7 of title 28, United States Code, is amended to read as follows:

"CHAPTER 7—UNITED STATES CLAIMS COURT

"Sec.
"171. Appointment and number of judges; character of court; designation of chief judge.
"172. Tenure and salaries of judges.
"173. Times and places of holding court.
"174. Assignment of judges; decisions.
"175. Official duty station; residence.
"716. Removal from office.
"717. Disbarment of removed judges.

"§171. Appointment and number of judges; character of court; designation of chief judge

"(a) The President shall appoint, by and with the advice and consent of the Senate, sixteen judges who shall constitute a court of record known as the United States Claims Court. The court is declared to be a court established under article I of the Constitution of the United States.

* * * * *

COURTS OF APPEALS JURISDICTION

SEC. 124. Section 1291 of title 28, United States Code, is amended—

(1) by inserting "(other than the United States Court of Appeals for the Federal Circuit)" after "courts of appeals"; and (2) by adding at the end thereof the following new sentence: "The jurisdiction of the United States Court of Appeals for the Federal Circuit shall be limited to the jurisdiction described in sections 1292(c) and (d) and 1295 of this title.".

INTERLOCUTORY DECISIONS

SEC. 125. (a) Section 1292(a) of title 28, United States Code, is amended—

(1) by striking out "The courts" and inserting in lieu thereof "Except as provided in subsections (c) and (d) of this section, the courts";

(2) by striking out the semicolon at the end of paragraph (3) and inserting in lieu thereof a period; and

(3) by striking out paragraph (4).

(b) Section 1292 of title 28, United States Code, is amended by adding at the end thereof the following new subsections:

"(c) The United States Court of Appeals for the Federal Circuit shall have exclusive jurisdiction—

"(1) of an appeal from an interlocutory order or decree described in subsection (a) of this section in any case over which the court would have jurisdiction of an appeal under section 1295 of this title; and

"(2) of an appeal from a judgment in a civil action for patent infringement which would otherwise be appealable to the United States Court of Appeals for the Federal Circuit and is final except for an accounting.

"(d)(1) When the chief judge of the Court of International Trade issues an order under the provisions of section 256(b) of this title, or when any judge of the Court of International Trade, in issuing any other interlocutory order, includes in the order a statement that a controlling question of law is involved with respect to which there is a substantial ground for difference of opinion and that an immediate appeal from that order may materially advance the ultimate termination of the litigation, the United States Court of Appeals for the Federal Circuit may, in its discretion, permit an appeal to be taken from such order, if application is made to that Court within ten days after the entry of such order.

"(2) When any judge of the United States Claims Court, in issuing an interlocutory order, includes in the order a statement that a controlling question of law is involved with respect to which there is a substantial ground for difference of opinion and that an immediate appeal from that order may materially advance the ultimate termination of the litigation, the United States Court of Appeals for the Federal Circuit may, in its discretion, permit an appeal to be taken from such order, if application is made to that Court within ten days after the entry of such order.

"(3) Neither the application for nor the granting of an appeal under this subsection shall stay proceedings in the Court of International Trade or in the Claims Court, as the case may be, unless a stay is ordered by a judge of the Court of International Trade or of the Claims Court or by the United States Court of Appeals for the Federal Circuit or a judge of that court.".

CIRCUITS IN WHICH DECISIONS ARE REVIEWABLE

SEC. 126. Section 1294 of title 28, United States Code (including that section as it will become effective on April 1, 1984), is amended by striking out "Appeals" and inserting in lieu thereof "Except as provided in sections 1292(c), 1292(d), and 1295 of this title, appeals".

JURISDICTION OF THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

SEC. 127. (a) Chapter 83 of title 28, United States Code, is amended by adding at the end thereof the following new sections:

"§1295. Jurisdiction of the United States Court of Appeals for the Federal Circuit

"(a) The United States Court of Appeals for the Federal Circuit shall have exclusive jurisdiction—

"(1) of an appeal from a final decision of a district court of the United States, the United States District Court for the District of the Canal Zone, the District Court of Guam, the District Court of the Virgin Islands, or the District Court for the Northern Mariana Islands, if the jurisdiction of that court was based, in whole or in part, on section 1338 of this title, except that a case involving a claim arising under any Act of Congress relating to copyrights or trademarks and no other claims under section 1338(a) shall be governed by sections 1291, 1292, and 1294 of this title;

"(2) of an appeal from a final decision of a district court of the United States, the United States District Court for the District of the Canal Zone, the District Court of Guam, the District

Court of the Virgin Islands, or the District Court for the Northern Mariana Islands, if the jurisdiction of that court was based, in whole or in part, on section 1346 of this title, except that jurisdiction of an appeal in a case brought in a district court under section 1346(a)(1), 1346(b), 1346(e), or 1346(f) of this title or under section 1346(a)(2) when the claim is founded upon an Act of Congress or a regulation of an executive department providing for internal revenue shall be governed by sections 1291, 1292, and 1294 of this title;

"(3) of an appeal from a final decision of the United States Claims Court;

"(4) of an appeal from a decision of—

"(A) the Board of Appeals or the Board of Patent Interferences of the Patent and Trademark Office with respect to patent applications and interferences, at the instance of an applicant for a patent or any party to a patent interference, and any such appeal shall waive the right of such applicant or party to proceed under section 145 or 146 of title 35;

"(B) the Commissioner of Patents and Trademarks or the Trademark Trial and Appeal Board with respect to applications for registration of marks and other proceedings as provided in section 21 of the Trademark Act of 1946 (15 U.S.C. 1071); or

"(C) a district court to which a case was directed pursuant to section 145 or 146 of title 35;

"(5) of an appeal from a final decision of the United States Court of International Trade;

"(6) to review the final determinations of the United States International Trade Commission relating to unfair practices in import trade, made under section 337 of the Tariff Act of 1930 (19 U.S.C. 1337);

"(7) to review, by appeal on questions of law only, findings of the Secretary of Commerce under headnote 6 to schedule 8, part 4, of the Tariff Schedules of the United States (relating to importation of instruments or apparatus);

"(8) of an appeal under section 71 of the Plant Variety Protection Act (7 U.S.C. 2461);

"(9) of an appeal from a final order or final decision of the Merit Systems Protection Board, pursuant to sections 7703(b)(1) and 7703(d) of title 5; and

"(10) of an appeal from a final decision of an agency board of contract appeals pursuant to section 8(g)(1) of the Contract Disputes Act of 1978 (41 U.S.C. 607(g)(1)).

"(b) The head of any executive department or agency may, with the approval of the Attorney General, refer to the Court of Appeals for the Federal Circuit for judicial review any final decision rendered by a board of contract appeals pursuant to the terms of any contract with the United States awarded by that department or agency which the head of such department or agency has concluded is not entitled to finality pursuant to the review standards specified in section 10(b) of the Contract Disputes Act of 1978 (41 U.S.C. 609(b)). The head of each executive department or agency shall make any referral under this section within one hundred and twenty days after the receipt of a copy of the final appeal decision.

"(c) The Court of Appeals for the Federal Circuit shall review the matter referred in accordance with the standards specified in section 10(b) of the Contract Disputes Act of 1978. The court shall proceed with judicial review on the administrative record made before the board of contract appeals on matters so referred as in other cases pending in such court, shall determine the issue of finality of the appeal decision, and shall, if appropriate, render judgment thereon, or remand the matter to any administrative or executive body or official with such direction as it may deem proper and just.

"§1296. Precedence of cases in the United States Court of Appeals for the Federal Circuit

"Civil actions in the United States Court of Appeals for the Federal Circuit shall be given precedence, in accordance with the law applicable to such actions, in such order as the court may by rule establish.".

(b) The section analysis of chapter 83 of title 28, United States Code, is amended by adding at the end thereof the following new items:

"1295. Jurisdiction of the United States Court of Appeals for the Federal Circuit.

"1296. Precedence of cases in the United States Court of Appeals for the Federal Circuit.".

* * * * *

UNITED STATES AS DEFENDANT; VENUE

SEC. 131. Section 1402(a) of title 28, United States Code, is amended by inserting "in a district court" after "civil action".

CURE OR WAIVER OF DEFECTS

SEC. 132. Section 1406 of title 28, United States Code, is amended—

(1) by repealing subsection (c); and

(2) by redesignating subsection (d) as subsection (c).

UNITED STATES CLAIMS COURT JURISDICTION AND VENUE

SEC. 133. (a) Section 1491 of title 28, United States Code, is amended to read as follows:

"§1491. Claims against United States generally; actions involving Tennessee Valley Authority

"(a)(1) The United States Claims Court shall have jurisdiction to render judgment upon any claim against the United States founded either upon the Constitution, or any Act of Congress or any regulation of an executive department, or upon any express or implied contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort. For the purpose of this paragraph, an express or implied contract with the Army and Air Force Exchange Service, Navy Exchanges, Marine Corps Exchanges, Coast Guard Exchanges, or Exchange Councils of the National Aeronautics and Space Administration shall be considered an express or implied contract with the United States.

"(2) To provide an entire remedy and to complete the relief afforded by the judgment, the court may, as an incident of and collateral to any such judgment, issue orders directing restoration to office or position, placement in appropriate duty or retirement status, and correction of applicable records, and such orders may be issued to any appropriate official of the United States. In any case within its jurisdiction, the court shall have the power to remand appropriate matters to any administrative or executive body or official with such direction as it may deem proper and just. The Claims Court shall have jurisdiction to render judgment upon any claim by or against, or dispute with, a contractor arising under section 10(a)(1) of the Contract Disputes Act of 1978.

"(3) To afford complete relief on any contract claim brought before the contract is awarded, the court shall have exclusive jurisdiction to grant declaratory judgments and such equitable and extraordinary relief as it deems proper, including but not limited to injunctive relief. In exercising this jurisdiction, the court shall give due regard to the interests of national defense and national security.

"(b) Nothing herein shall be construed to give the United States Claims Court jurisdiction of any civil action within the exclusive jurisdiction of the Court of International Trade, or of any action against, or founded on conduct of, the Tennessee Valley Authority, or to amend or modify the provisions of the Tennessee Valley Authority Act of 1933 with respect to actions by or against the Authority.".

(b) Section 1492 of title 28, United States Code, is amended by striking out "chief commissioner of the Court of Claims" and inserting in lieu thereof "chief judge of the United States Claims Court".

(c)(1) Sections 1494, 1495, 1496, and 1497 of title 28, United States Code, are amended by striking out "Court of Claims" each place it appears and inserting in lieu thereof "United States Claims Court".

(2) The section heading of section 1497 of title 28, United States Code, is amended by striking out "growers," and inserting in lieu thereof "growers' ".

(d) Section 1498 of title 28, United States Code, is amended—

(1) in subsection (a), by striking out "Court of Claims" and inserting in lieu thereof "United States Claims Court"; and

(2) in subsections (b) and (d), by striking out "Court of Claims" each place it appears and inserting in lieu thereof "Claims Court".

(e)(1) Sections 1499, 1500, 1501, 1502, and 1503 of title 28, United States Code, are amended by striking out "Court of Claims" each place it appears and inserting in lieu thereof "United States Claims Court".

(2)(A) The section heading of section 1499 of title 28, United States Code, is amended by inserting "and Safety" after "Hours".

(B) The item relating to section 1499 in the section analysis of chapter 91 of title 28, United States Code, is amended to read as follows:

"1499. Liquidated damages withheld from contractors under Contract Work Hours and Safety Standards Act.".

(f) Section 1504 of title 28, United States Code, and the item relating to section 1504 in the section analysis of chapter 91 of such title, are repealed.

(g) Section 1505 of title 28, United States Code, is amended—

(1) by striking out "Court of Claims" the first place it appears and inserting in lieu thereof "United States Claims Court"; and

(2) by striking out "Court of Claims" the second place it appears and inserting in lieu thereof "Claims Court".

(h) Section 1506 of title 28, United States Code, and the item relating to section 1506 in the section analysis of chapter 91 of such title, are repealed.

(i) Section 1507 of title 28, United States Code, is amended by striking out "Court of Claims" and inserting in lieu thereof "United States Claims Court".

(j)(1) The item relating to chapter 91 in the chapter analysis of part IV of title 28, United States Code, is amended by striking out "Court of Claims" and inserting in lieu thereof "United States Claims Court".

(2) The chapter heading of chapter 91 of title 28, United States Code, is amended by striking out "COURT OF CLAIMS" and inserting in lieu thereof "UNITED STATES CLAIMS COURT".

* * * * *

COURT OF APPEALS JURISDICTION

SEC. 137. Section 2342 of title 28, United States Code, is amended—

(1) by inserting "(other than the United States Court of Appeals for the Federal Circuit)" after "court of appeals";

(2) in paragraph (4), by inserting "and" after the semicolon;

(3) in paragraph (5), by striking out "; and" and inserting in lieu thereof a period; and

(4) by striking out paragraph (6).

* * * * *

PART B—CONFORMING AMENDMENTS OUTSIDE TITLE 28

* * * * *

INTERNAL REVENUE CODE

SEC. 151. Section 7422(e) of the Internal Revenue Code of 1954 (26 U.S.C. 7422(e)) is amended by striking out "Court of Claims" each place it appears and inserting in lieu thereof "United States Claims Court".

INTERNAL REVENUE CODE

SEC. 152. Section 7428 of the Internal Revenue Code of 1954 is amended by striking out "Court of Claims" each place it appears and inserting in lieu thereof "Claims Court".

INTERNAL REVENUE CODE

SEC. 153. (a) The second sentence of section 7456(c) of the Internal Revenue Code of 1954 is amended to read as follows: "Each commissioner shall receive pay at an annual rate determined under section 225 of the Federal Salary Act of 1967 (2 U.S.C. 351-361), as adjusted by section 461 of title 28, United States Code, and also necessary traveling expenses and per diem allowances, as provided in subchapter I of chapter 57 of title 5, United States Code, while traveling on official business and away from Washington, District of Columbia.".

(b) Notwithstanding the amendment made by subsection (a), until such time as a change in the salary rate of a commissioner of the United States Tax Court occurs in accordance with section 7456(c) of the Internal Revenue Code of 1954, the salary of such commissioner shall be equal to the salary of a commissioner of the Court of Claims immediately prior to the effective date of this Act.

INTERNAL REVENUE CODE

SEC. 154. Section 7482(a) of the Internal Revenue Code of 1954 is amended by inserting "(other than the United States Court of Appeals for the Federal Circuit)" after "United States Court of Appeals".

* * * * *

CONFORMING AMENDMENTS

SEC. 160. (a) The following provisions of law are amended by striking out "Court of Claims" each place it appears and inserting in lieu thereof "United States Claims Court":

* * * * *

(9) Section 6110(i)(1) of the Internal Revenue Code of 1954.

* * * * *

TITLE II—GOVERNANCE AND ADMINISTRATION OF THE FEDERAL COURTS

* * * * *

PART D—JUDICIAL RESIGNATION; PENSIONS

PENSIONS OF JUDGES WHO RESIGN TO ACCEPT EXECUTIVE POSITIONS

SEC. 207. ***

(b) Section 8334 of title 5, United States Code, is amended by inserting at the end thereof the following new subsection:

"(i)(1) The Director of the Administrative Office of the United States Courts shall pay to the Fund the amount which an employee may deposit under subsection (c) of this section for services creditable under section 8332(b)(12) of this title if such creditable service immediately precedes service as an employee subject to this subchapter with a break in service of no more than ninety working days. The Director shall pay such amount from any appropriation available to him as a necessary expense of the appropriation concerned.

"(2) The amount the Director pays in accordance with paragraph (1) of this subsection shall be reduced by the amount of any refund to the employee under section 376 of title 28. Except to the extent of such reduction, the amount the Director pays to the Fund shall satisfy the deposit requirement of subsection (c) of this section.

"(3) Notwithstanding any other provision of law, the amount the Director pays under this subsection shall constitute an employer contribution to the Fund, excludable under section 402 of the Internal Revenue Code of 1954 from the employee's gross income until such time as the contribution is distributed or made available to the employee, and shall not be subject to refund or to lump-sum payment to the employee.".

* * * * *

TITLE III—JURISDICTION AND PROCEDURE

* * * * *

PART B—INTEREST

INTEREST ON JUDGMENTS

SEC. 302. (a) Section 1961 of title 28, United States Code, is amended—

(1) by inserting "(a)" immediately before "Interest shall" in the first sentence;

(2) by striking out "at the rate allowed by State law" in the last sentence and inserting in lieu thereof the following: "at a rate equal to the coupon issue yield equivalent (as determined by the Secretary of the Treasury) of the average accepted auction price for the last auction of fifty-two week United States Treasury bills settled immediately prior to the date of the judgment. The Director of the Administrative Office of the United States Courts shall distribute notice of that rate and any changes in it to all Federal judges"; and

(3) by adding at the end thereof the following new subsections:

"(b) Interest shall be computed daily to the date of payment except as provided in section 2516(b) of title 28, United States Code, and section 1302 of the Act of July 27, 1956 (31 U.S.C. 724a), and shall be compounded annually.

"(c)(1) This section shall not apply in any judgment of any court with respect to any internal revenue tax case. Interest shall be allowed in such cases at a rate established under section 6621 of the Internal Revenue Code of 1954.

* * * * *

TITLE IV—MISCELLANEOUS PROVISIONS

* * * * *

EFFECTIVE DATE

SEC. 402. Unless otherwise specified, the provisions of this Act shall take effect on October 1, 1982.

EFFECT ON PENDING CASES

SEC. 403. (a) Any case pending before the Court of Claims on the effective date of this Act in which a report on the merits has been filed by a commissioner, or in which there is pending a request for review, and upon which the court has not acted, shall be transferred to the United States Court of Appeals for the Federal Circuit.

(b) Any matter pending before the United States Court of Customs and Patent Appeals on the effective date of this Act shall be transferred to the United States Court of Appeals for the Federal Circuit.

(c) Any petition for rehearing, reconsideration, alteration, modification, or other change in any decision of the United States Court of Claims or the United States Court of Customs and Patent Appeals rendered prior to the effective date of this Act that has not been determined by either of those courts on that date, or that is filed after that date, shall be determined by the United States Court of Appeals for the Federal Circuit.

(d) Any matter pending before a commissioner of the United States Court of Claims on the effective date of this Act, or any pending dispositive motion that the United States Court of Claims has not determined on that date, shall be determined by the United States Claims Court.

(e) Any case in which a notice of appeal has been filed in a district court of the United States prior to the effective date of this Act shall be decided by the court of appeals to which the appeal was taken.

Approved April 2, 1982.

House of Representatives Report No. 97-312

1st Session

[Bracketed numerals indicate official report page number]

COURT OF APPEALS FOR THE FEDERAL CIRCUIT ACT OF

November 4, 1981

MR. KASTENMEIER, from the Committee on the Judiciary, submitted the following Report together with Dissenting Views to accompany H.R. 4482 [1]

---

[1] Public Law 97-164, page 316.

[Including cost estimate of
the Congressional Budget Office]

The Committee on the Judiciary, to whom was referred the bill (H.R. 4482) to establish a United States Court of Appeals for the Federal Circuit, to establish a United States Claims Court, and for other purposes, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

* * * * *

[16] PURPOSE OF THE BILL

H.R. 4482 establishes a new intermediate appellate court to be called the United States Court of Appeals for the Federal Circuit. Creation of this court is accomplished through a merger of the [17] United States Court of Claims and the United States Court of Customs and Patent Appeals ("CCPA") into a single appellate court with expanded jurisdiction. The creation of this new court substantially improves the administration of the law in the areas of patents, government contracts, merit system protection, trademarks and international trade; provides a tribunal capable of exercising intermediate appellate jurisdiction nationwide; and results in improved functioning of the federal appellate system.

H.R. 4482 also creates a new Article I trial forum known as the United States Claims Court, which inherits the trial jurisdiction of the Court of Claims. The creation of this court provides an upgraded and better organized trial forum for government claims cases.

BACKGROUND AND NEED FOR LEGISLATION

Responding to the Federal Appellate Crisis

Over the past two decades, the caseload of the federal appellate system has grown so large that a crisis has arisen. Between 1962 and 1981, appellate court filings increased more than fivefold from 4,832 cases to 26,362. At the same time, the number of federal circuit judges increased only from 78 to 132. The caseload of each judge more than tripled during this period. Although the addition of the 35 new appellate judges authorized as the Omnibus Judgeship Act of 1978 (Public Law 95-486) has helped the courts of appeals to keep pace with their work, the trend toward increased appellate court filings has continued. The addition of numerous district court judges, also created by the 1978 Omnibus Judgeship Bill, coupled with legislation conferring increased powers on bankruptcy judges (see Public Law 95-598) and magistrates (see Public Law 96-82) have generated more lower court decisions requiring appellate review. The net result is that the federal appellate system faces a crisis that actually is worsening rather than being solved. This is a crisis that does not only affect judges. As stated in a report of the Department of Justice:

> This is not a crisis for the courts alone. It is a crisis for litigants who seek justice, for claims of human rights, for the rule of law, and it is therefore a crisis for the Nation.[1]

Unfortunately, a solution to the rising tide of appellate work is not facile. It is neither possible nor desirable to continually add new judges to the federal judicial pyramid. Such an approach is, at best, a short-term solution. It may create more problems than it solves. The mere addition of new judgeships itself creates problems such as increased intracircuit conflicts, unwieldly en banc proceedings and a loss in judicial collegialtity.[2] As former Judge Shirley M. Hufstedler observed:

> A judicial system cannot be expanded horizontally beyond the capacity of the next tier to process the added [18] cases. For that reason, district courts cannot be indefinitely expanded, unless access to the appellate courts is correspondingly curtailed. A judicial system cannot be indefinitely expanded vertically because cases that should reach the top of the ladder fall by the wayside due to delay, expense, or battle fatigue.
>
> Judicial personnel cannot be indefinitely added without imperiling the quality of persons attracted to the bench. Nonjudicial personnel cannot be perpetually increased without turning courts into the impersonal bureaucracies which the litigants are trying to escape.
>
> In short, federal judicial time is a scarce commodity. The supply can be increased a little, but very little, without impairing or destroying its value. We must face up to the fact that we have to treat federal judicial time as we have treated other essential resources in the periods of shortage. We have to inventory our present and future supply to ascertain the totality for distribution.[3]

The new court that results from the merger brought about by this bill will help alleviate the docket pressures on the regional courts of appeals by reallocating and realigning existing judicial resources, not by adding new ones. No new judgeships are created;[4] and the number of federal courts within the system is not increased.

The United States Court of Appeals for the Federal Circuit

The essence of the proposal is the provision for a new intermediate appellate court. The Court of Claims and the Court of Customs and Patent Appeals are merged into a single appellate court which would take over the merged courts' twelve judgeships. The resulting United States Court of Appeals for the Federal Circuit is an Article III court at the same level as the existing circuit courts of appeals. The new court will function like these other appellate courts; but its jurisdiction, like that of the courts it replaces, is defined by subject matter rather than geography. It inherits all the appellate jurisdiction of the two existing courts. Thus, the new court will hear appeals in suits against the government for damages or for the refund of federal taxes, appeals from the Court of International Trade, appeals from the Patent and Trademark Office, and a few other agency review cases. In addition, the court has jurisdiction over all federal contract appeals in which the United States is a defendant, over patent appeals from all federal district courts, and over all appeals from the Merit Systems Protection Board (including cases over which the Court of Claims did not have jurisdiction [5]). Review of the new court's decisions will be in the Supreme Court by petition for writ of certiorari.

---

[1] Report of the Department of Justice Committee on Revision of the Federal Judicial System 1 (1977).

[2] *See* H.R. Rept. No. 95-858, 95th Cong., 2d Sess. (1978). In its report on the Omnibus Judgeship Bill, this Committee found that the federal judiciary cannot be enlarged indeterminably without threatening its high quality. Creation of judgeships leads unavoidably to the creation of more and more judicial staff, with attendant problems of judicial bureaucratization – something avoided in the past – becoming a problem. *See* Rubin, Bureaucratization of the Federal Courts: The Tension Between Justice and Efficiency, 55 Notre Dame L. Rev. 648 (1980).

[3] State of the Judiciary and Access to Justice: Hearings before the House Judiciary Subcommittee on Courts, Civil Liberties and the Administration of Justice, 95th Cong., 1st Sess. 149 (1977) (statement of Shirley M. Hufstedler) [hereinafter referred to as House Hearings on the State of the Judiciary]; *see also Id.* at 112 (statement of Burt Neuborne); Hufstedler, New Blocks for Old Pyramids: Reshaping the Judicial System, 44 So.Cal.L. Rev. 901 (1971).

[4] The sixteen trial commissioners employed by the Court of Claims, previously designated by rule of court as trial judges, are elevated to the status of Article I judges.

[19] *Reducing Judicial Specialization*

By combining the jurisdiction of the two existing courts along with certain limited grants of new jurisdiction, the bill creates a new intermediate appellate court markedly less specialized than either of its predecessors and provides the judges of the new court with a breadth of jurisdiction that rivals in its variety that of the regional courts of appeals. The proposed new court is not a "specialized court." Its jurisdiction is not limited to one type of case, or even to two or three types of cases. Rather, it has a varied docket spanning a broad range of legal issues and types of cases. It will handle all patent appeals and some agency appeals, as well as all other matters that are now considered by the CCPA or the Court of Claims. The Court of Claims decides cases involving federal contracts, civil tax issues if the government is the defendant, Indian claims, military and civilian pay disputes, patents, inverse condemnation, and various other matters.[6] The CCPA decides patents and customs cases from several sources, and those cases often include allegations of defenses of "misuse, fraud, inequitable conduct, violation of the antitrust laws, breach of trade secret agreements, unfair competition, and such common law claims as unjust enrichment." [7]

Meeting the Imperatives of Appellate Justice

The proposed court also will score positively with respect to various lessons of appellate court reform that emerged from various well-known study groups and committees, including the Freund Committee, the Hruska Commission, and the Advisory Council for Appellate Justice.[8] First, the proposal is for a new court, free of jurisdictional uncertainties and composed of permanent Article III judges of its own. Second, the number of judges within the Federal judiciary does not increase; and the number of courts actually decreases. Third, no new tier of courts is added to the Federal judicial system and the status of other existing courts and judges is not diminished. Access to and review by the Supreme Court remains unchanged.[9]

Transitional Provisions

As a transitional measure, the persons occupying the twelve Article III judgeships of the two existing courts on the effective date of this legislation (October 1, 1982) become judges of the new court. Their positions are designated as United States circuit judgeships; and future vacancies on the court will be filled by Presidential appointment, with Senatorial confirmation.

[20] As a further transitional feature, the first chief judge of the Court of Appeals for the Federal Circuit will be the chief judge of the Court of Claims or the chief judge of the Court of Customs and Patent Appeals, whoever has served longer as chief judge of his respective court. The junior chief judge is deemed senior in commission over all the other circuit judges on the new court. Successor chief judges of the Federal Court will be chosen by seniority of commission, in the manner prescribed for other United States courts of appeals under 28 U.S.C. 45.

Location and Panel Composition

The new appellate court has its headquarters in Washington, D.C., in the facilities presently shared by the two existing courts. By rule of court, it can sit at other designated places throughout the country. Indeed, it is the prevailing view of the committee that the new court, adequate caseload permitting, should make diligent efforts to sit throughout the country. The court will sit in panels of three or more judges or en banc. Under existing law, other United States courts of appeals are authorized to decide cases in separate divisions, each consisting of three judges. *See* 28 U.S.C. 46(b). Since the jurisdiction of the Court of Appeals for the Federal Circuit consists of an unusual number of complex cases in which current law lacks uniformity or is inconsistently applied, and since the new court's decisions are intended to have nationwide precedential effect, the legislation authorizes the judges of the Federal Circuit to determine the size of the panels in which the court will sit, with the provision, however, that panels cannot consist of less than three judges. This permits the Federal Circuit to sit in panels of more than three judges, but as less than a full en banc court, for cases in which authoritativeness of decision and doctrinal stability could be enhanced by the use of larger panels.

The Need for Increased Uniformity in Patent Law

The establishment of a single court to hear patent appeals was repeatedly singled out by the witnesses who appeared before the Committee as one of the most far-reaching reforms that could be made to strengthen the United States patent system in such a way as to foster technological growth and industrial innovation. The new Court of Appeals for the Federal Circuit will provide nationwide uniformity in patent law, will make the rules applied in patent litigation more predictable and will eliminate the expensive, time-consuming and unseemly forum-shopping that characterizes litigation in the field.

---

[5] *See Dunn* v. *United States, Dept. of Agriculture, appeal No. 2-80, decided June 17, 1981 (Ct. Cl.)*

[6] *See* 28 U.S.C. sections 1491-1507.

[7] *See* Kauper (Statement submitted to the Hruska Commission, May 20, 1974, at 14 (unpublished; on file with National Archives). *See* 28 U.S.C. section 1541-1545.

[8] To increase the capacity of the federal judicial system for definite adjudication of issues of national law, various proposals for restructuring the federal appellate courts have been considered in recent years by lawyers, jurists, and academicians. Detailed recommendations have been developed by the Study Group on the Caseload of the Supreme Court (the Freund Committee), the Committee on Revision of the Federal Court Appellate System (the Hruska Commission), and the Advisory Council for Appellate Justice chaired by Professor Maurice Rosenberg. *See* Federal Judicial Center, Report of the Study Group on the Caseload of the Supreme Court (1972): Commission on Revision of the Federal Court Appellate System, Structure and Internal Procedures: Recommendations for Change, *reprinted in* 67 F.R.D. 195 (1975): *and* Advisory Council for Appellate Justice. Recommendations for Improving the Federal Intermediate Appellate System (1975), *See generally* House Hearings on the State of the Judiciary, *Supra* note 3, at 220, 620. *See also* Friendly, Federal Jurisdiction: A General view (1973).

[9] For a discussion of the imperatives of appellate justice, see P. Carrington, D. Meador, M. Rosenberg, Justice on Appeal 7-13 (1976).

Patent litigation long has been identified as a problem area, characterized by undue forum-shopping and unsettling inconsistency in adjudications. Based on the evidence it compiled during the course of thorough hearings on the subject, the Commission on Revision of the Federal Court Appellate System—created by Act of Congress—concluded that patent law is an area in which the application of the law to the facts of a case often produces different outcomes in different courtrooms in substantially similar cases.[10] As a result, some circuit courts are regarded as "pro-patent" and [21] other "anti-patent," and much time and money is expended in "shopping" for a favorable venue. In a Commission survey of practitioners, the patent bar reported that uncertainty created by the lack of national law precedent was a significant problem; the Commission found patent law to be an area in which widespread forum-shopping was particularly acute.[11]

Presently, there are three possible forums for patent litigation: the Court of Customs and Patent Appeals, a federal district court, or the Court of Claims. Although these multiple avenues of review do result in some actual unresolved conflicts in patent law, the primary problem in this area is uncertainty which results from inconsistent application of the law to the facts of an individual case. Even in circumstances in which there is no conflict as to the actual rule of law, the courts take such a great variety of approaches and attitudes toward the patent system that the application of the law to the facts of an individual case produces unevenness in the administration of the patent law. Perceived disparties between the circuits have led to "mad and undignified races" between alleged infringers and patent holders to be the first to institute proceedings in the forum they consider most favorable.

The Hruska Commission's patent law consultants deplored the forum-shopping that occurs in that field of the law. It was pointed out that, at least when the issue turned on validity:

> [p]atentees now scramble to get into the 5th, 6th, and 7th circuits since the courts there are not inhospitable to patents whereas infringers scramble to get anywhere but in these circuits.[12]

They concluded that forum-shopping on this scale:

> not only increases litigation costs inordinately and decreases one's ability to advise clients, it demeans the entire judicial process and the patent system as well.[13]

During its hearings held during the 96th and 97th Congresses, the Subcommittee on Courts, Civil Liberties and the Administration of Justice received the benefit of comments from distinguished jurists, patent practitioners and representatives of major technologically-oriented business enterprises. The great weight of their testimony confirmed the findings of the Hruska Commission that patent cases are inconsistently adjudicated.

Chief Judge Howard T. Markey of the Court of Customs and Patent Appeals confirmed the existence of this problem in patent law and the fact that the merger proposal directly addresses the issue.[14] Chief Judge Daniel M. Friedman of the Court of Claims also testified to the improvement in the federal judicial system that [22] would be brought about by the proposal.[15] Speaking on behalf of the Judicial Conference of the United States, both judges expressed strong support for the legislation.[16]

At present, the validity of a patient is too dependent upon geography [17] (*i.e.*, the accident of judicial venue) to make effective business planning possible. It is particularly difficult for small businesses to make useful and knowledgeable investment decisions where patents are involved when they fear a patent may be tied up for years in expensive litigation and when the standard of patentability varies from circuit to circuit.[18] A single court of appeals for patent cases will promote certainty where it is lacking to a significant degree and will reduce, if not eliminate, the forum-shopping that now occurs.[19]

Former Secretary of Commerce Philip M. Klutznick testified in support of the proposal:

> Decisions to file patent applications and to invest in commercializing inventions would be improved meaningfully as a result of the greater uniformity and reliability made possible***.[20]

For these reasons the establishment of a single court to hear patent appeals was a major recommendation of the Domestic Policy Review initiated by President Jimmy Carter and was an indispensable part of the President's industrial innovation program. The proposal was expressly endorsed by President Carter in a message to the Congress on February 17, 1979.[21]

The sentiment of the users of the patent system on this score is particularly compelling. For example, the Industrial Research Institute, a private, non-profit corporation with a membership of approximately 250 industrial companies that account for a major portion of the industrial research and

---

[10] *See* Commission on Revision of the Federal Court Appellate System, Structure and Internal Procedures: Recommendations for Change, 15, 144-57, 67 F.R.D. 195, 214, 361-76 (1975) (hereinafter "Hruska Commission Report"). The Hruska Commission was created by Public Law 92-489.

[11] *Id.* at 144-57, 67 F.R.D. at 361-76; *see also* letter from A. Leo Levin to Honorable Robert W. Kastenmeier (April 29, 1981) *reprinted in* Hearings on the Court of Appeals for the Federal Circuit Before the House Judiciary Subcommittee on Courts, Civil Liberties and the Administration of Justice 97th Cong., 1st Sess. 257 (1981) [hereinafter referred to as House Hearings on the Court of Appeals for the Federal Circuit].

[12] Hruska Commission Report, *supra* note 10 at 152, 67 F.R.D. at 370. Conclusions of the Commission's consultants, Professor James B. Gambrell and Donald R. Dunner, Esq.

[13] *Id.* During the 96th Congress, on behalf of the American Patent Law Association, Mr. Dunner testified forcefully in favor of the creation of a new court. *See* House Hearings on Industrial Innovation and Patent and Copyright Law Amendments Before the House Judiciary Subcommittee on Courts, Civil Liberties and the Administration of Justice, 96th Cong , 2d Sess. 92 (1980) [hereinafter referred to as House Hearings on Industrial Innovation].

[14] House Hearings on Industrial Innovation, *supra* note 11, at 725; House Hearings on the Court of Appeals for the Federal Circuit, *supra* note 13, at 2.

[15] House Hearings on Industrial Innovation, *supra* note 11, at 707; House Hearings on the Court of Appeals for the Federal Circuit, *supra* note 13 at 15.

[16] House Hearings on the Court of Appeals for the Federal Circuit, *supra* note 13, at 2-47.

[17] House Hearings on Industrial Innovation, *supra* note 11, at 47.

[18] House Hearings on Industrial Innovation, *supra* note 11, at 241, 272. (Statement of Eric E. Schellin, on behalf of the National Small Business Association, the Small Business Legislative Council, the American Society of Inventors and the National Patent Council).

[19] *Id.* at 625, 628. (Statement of Harry I. Manbeck, Jr., General Patent Counsel, General Electric Company, on behalf of the Committee for Economic Development).

[20] *Id.* at 2, 8. (Statement of Philip M. Klutznick).

[21] 125 *Cong. Record* 11911 (daily ed., Feb. 27, 1979).

[24]

Type of case	Filed	Terminated
Caseload in the Court of Customs and Patent Appeals fiscal year 1979:		
Customs, commerce and international trade	35	30
Patent and Trademark	124	124
Total CCPA cases	159	154
Appellate caseload in the Court of Claims, fiscal year 1979:		
Total dispositions by article III judges:		
In chambers	264	
Calendared	198	
Requests for review	50	
Total article III judge workload	512	

development conducted in the United States, polled its membership and found them overwhelmingly in favor of centralizing patent appeals in a single court.[22]

The infrequency of Supreme Court review of patent cases leaves the present judicial system without any effective means of assuring even-handedness nationwide in the administration of the patent laws. The proposed new court will fill this void.

Directing patent appeals to the new court will have the beneficial effect of removing these unusually complex, technically difficult, and time-consuming cases from the dockets of the regional [23] courts of appeals.[23] This will leave those courts better able to handle other types of cases that flow to them. Although the creation of the new court will therefore reduce the workload of the appellate courts, case management is not the primary goal of the legislation; rather, the central purpose is to reduce the widespread lack of uniformity and uncertainty of legal doctrine that exist in the administration of patent law.

Removing the incentive to forum-shop also will reduce costs to litigants. The reduction of such costs will promote investment in innovative products and new technology. Moreover, as the new court brings uniformity to this field of law, the number of appeals resulting from attempts to obtain different rulings on disputed legal points can be expected to decrease. As in all contestable situations, a more predictable outcome will encourage the contestants to avoid litigation: as aptly observed by one witness, ". . . the rules of law need not be challenged daily, to reinforce the rule of law." [24]

Similarly, the uniformity in the law that will result from the centralization of patent appeals in a single court will be a significant improvement from the standpoint of the industries and businesses that rely on the patent system. Business planning becomes easier as more stable and predictable patent law is introduced. Patents have served as a stimulus to the innovative process. This can have important positive ramifications for the nation's economy.

Other Advantages

The creation of a single new appellate entity has other distinct advantages. The Court of Claims and the Court of Customs and Patent Appeals were historically justified at the time they were created, and those courts have done a good job with the cases that have been assigned to them through the years. But the merger of these two courts now will reduce some overlapping functions and would provide for more efficient court administration. From a practical standpoint, the merger of the Court of Claims and the CCPA can be accomplished with minimal disruption. The courts presently occupy but do not quite fill the Courts Building on Lafayette Square in Washington, D.C., sharing the library and dining facilities. There is a standing order of the Judicial Conference allowing the interchange of judges between the two courts.[25]

An analysis of the workload of the proposed new court discloses that this merger also can be accomplished easily in terms of caseload.[26] In addition to inheriting the jurisdiction of the CCPA and the Court of Claims, the new appellate court will also receive patent appeals and all appeals in federal contract cases brought against the United States that are presently heard in the regional courts of appeals. The new court's appellate jurisdiction in patent cases is defined in relation to the district court's jurisdiction; that is, if the district court has jurisdiction over the case under 28 U.S.C. §1338(a), on the ground that the case arises under the patent law, the appeal in that cases will go to the new appellate court, instead of to the regional circuit.

On a projection of 1981 figures, the new court will be handling 159 cases that would otherwise have been heard by the CCPA, 512 cases that would have been heard by the Court of Claims, and approximately 350 patent or federal contract cases coming directly from the district courts that would have been heard by the regional courts of appeals. This will provide an appellate docket of about 1,021 cases. Detailed figures are not available concerning appeals from the newly created Merit Systems Protection Board, although it is known that in 1981 a total of 74 of these cases were filed in the Court of Claims.

---

[22] House Hearings on the Court of Appeals for the Federal Circuit, *supra* note 13, at 182. (Statement of Richard C. Witte). Further, the committee has received favorable written comments and strong support from over one hundred important corporations. *See Id.* at 191 (statement of Pauline Newman, on behalf of the Ad Hoc Committee in Support of a Single Court of Appeals).

[23] In recent years, many patent appeals in the regional circuits have experienced intervals of more than two years from filing to decision. By contrast, the average interval in the CCPA is less than eight months. *See* 1979 Ann. Rep. Dir. A.O., Table G-2b, at A-122.

[24] *Id.* at 197 (statement of Pauline Newman).

[25] See Report of the Proceedings of the Judicial Conference of the United States, September 23-24, 1976, at 53.

[26] According to the statistics provided by the Administrative Office of U.S. Courts, the dockets of both existing courts are current. Set out below are tables showing the sources of cases for the proposed court:

The United States Claims Court

A second, and equally important, aspect of the bill is the creation of a new Article I trial forum known as the United States Claims Court. The Claims Court inherits substantially all the trial jurisdiction of the Court of Claims.

The Court of Claims is theoretically a trial court. In practice, the trial function of the Court is discharged by commissioners appointed by the Court. The Court itself sits as an appellate court reviewing the decisions of the commissioners. Under the proposed legislation, the Claims Court essentially will have the same jurisdiction that the Court of Claims now exercises through its Trial Division under the Tucker Act, 28 U.S.C. §1491, together with the authority to enter final judgment. This includes "any claim against the United States founded either upon the Constitution, or any Act of Congress, or any regulation of an executive department, or upon any express or impled contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort." This jurisdiction covers tax refund suits, contract claims, civilian and military pay cases, suits seeking just compensation for inverse condemnation (situations in which the United States has taken action that deprives someone of a property interest), suits by Indian tribes and individual Indians, suits alleging that the United States or its contractors have infringed a patent, as well as a wide variety of other cases that either come within the jurisdictional authority of the Tucker Act or that Congress specifically has authorized the court to determine.

In short, the Claim Court's jurisdiction is substantially the same as the trial jurisdiction of the current Court of Claims, with the [25] sole exception that it will not hear Federal Tort Claims Act cases. Only one such case has ever been filed in the Court of Claims; since these cases frequently involve the application of state law, they will continue to go to the district courts and to the regional courts of appeals.

The new Claims Court also will be able to exercise equitable relief power—declaratory judgments and such extraordinary relief as it deems proper, including injunctive relief—in contract actions prior to award. This will permit the Claims Court to enjoin the award of contacts if, for example, illegal government conduct is involved.

The new United States Claims Court is composed of sixteen Article I judges, who will be appointed by the President with the consent of the Senate. They will serve for a term of fifteen years. This represents a significant improvement in assuring the independence of the trial function over the present situation in which the trial commissioners serve at the pleasure of the judges reviewing their decisions.

The chief judge of the Claims Court will be designated by the President of the United States. He or she will continue to serve as the judge until reaching the age of seventy and until another judge is designated as chief judge by the President. As a transitional measure, persons in active service as trial commissioners of the Court of Claims on the effective date of this legislation become Article I judges of the United States Claim Court. They will serve for initial terms that shall expire on October 1, 1986, but will be eligible for reappointment by the President to full fifteen-year terms. It is the expectation of the Committee that the President will carefully balance the twin obligations of providing adequate transition from the old to the new court by reappointing sitting commissioners to the new body, and at the same time, of selecting individuals to be judges on the basis of merit, regardless of race, sex, religion or national origin.

Like the present Court of Claims and the Tax Court, the Claims Court is authorized to sit nationwide. The court is required to establish times and places of its sessions with a view toward minimizing inconvenience and expense to litigants. This is an important obligation and the Committee expects the Claims Court will take it seriously.

Changes in the existing structure of the Court of Claims have been advocated by practitioners with extensive experience before the court [27] and by the commissioners themselves. The establishment of the Claims Court accomplishes a much needed reorganization of the current system by assigning the trial function of the court to trial judges whose status is upgraded and who are truly independent. Presently, the commissioners of the Court of Claims are appointed by the article III judges of that court and do not have the power to enter dispositive orders; final judgment in a case must be made by the article III judges after reviewing findings of fact and recommendations of law submitted by a commissioner. Thus, every case, in effect, is appealed in order to receive a final judgment even though no party expects the commissioner to be [26] reversed. The creation of the United States Claims Court will reduce delay in individual cases and will produce greater efficiencies in the handling of the court's docket by eliminating some of the overlapping work that has occurred as a result of this process.

Constitutionality

Congress has an independent and affirmative obligation continually to determine the constitutionality of legislation [28] During the 96th and 97th Congresses, the Committee considered the possible constitutional questions that arise from the reallocation of the personnel of the Court of Claims and of the Court of Customs and Patent Appeals to the new Court of Appeals for the Federal Circuit or the new Claims Court. The Committee has concluded there is no constitutional objection to these reallocations.[29]

---

[27] *See* House hearings on the court of Appeals for the Federal Circuit, *supra* note 13, at 158 (statement of Clarence T. Kipps and Steven C. Lambert on behalf of the Bar Association of the District of Columbia).

[28] *See* Brest. *The Conscientious Legislator's Guide to Constitutional Interpretation*, 27 Stan. L. Rev. 585 (1975); (H. Rep. No. 96-287 96th Cong., 1st Sess. 1979).

It is important to characterize the Claims Court grandfathering clause for what it really is. It merely continues the trail commissioners in office as judges of a reorganized court, with additional authority, for a limited transition period. Congress has eliminated courts and transferred judges to new or other courts in the past. *See, e.g.*, Act of October 22, 1913, ch. 32, 38 Stat. 208, 219 (abolishing Commerce Court and transferring judges to district courts and courts of appeals); District of Columbia Self-Government and Governmental Reorganization Act, Public Law 93-198, §431(c), 87 Stat. 774, 793 (December 24, 1973) (grandfathering District of Columbia judges). Second, after the Claims Court has come into existence, the power of the appointment is vested in the President, by and with the advice and consent of the Senate. Likewise, this does not have a constitutional infirmity. The provisions of the bill merely delay the date on which the President has power to nominate and, by and with the advice and consent of the Senate, appoint the judges of the Claims Court. Further, the bill provides a mechanism by which the power of appointment may be accelerated: the death, resignation or retirement of a sitting judge. For further analysis of these considerations, *See* memorandum from American Law Division to Hon. Robert Kastenmeier (Leland E. Beck, Oct. 2, 1981). Therefore the Committee finds no constitutional infirmity in the grandfathering clauses of the proposed legislation.

Likewise, as relates to the Court of Appeals foı the Federal Circuit, the Committee can see consitutional problems. The Committee has concluded that it is also permissible under *Shoemaker* for Congress by statute, and without a fresh Presidential [27] nomination and senatorial confirmation, to make the judges of the Court of Claims and the Court of Customs and Patent Appeals, upon the abolition of those courts, judges of the newly created United States Court of Appeals for the Federal Circuit. No loss of authority, status, tenure, or compensation is involved and no judge is removed from hearing cases he had previously heard. It is, in the Committee's view, within Congress' power under Article I, section 8, cl. 9 and 18, to reallocate the business and personnel of the lower federal courts under these conditions.

Conclusion

In summary, consolidation of the Court of Claims and the Court of Customs and Patent Appeals is constitutionally permissible and logistically and technically uncomplicated. Furthermore, it will make maximum use of available facilities and personnel and make only a modest change in federal appellate court structure. It will reduce the incentive to forum-shop and bring desirable uniformity to an important area of the law. The number of appeals resulting from attempts to obtain different rulings on disputed legal points can be expected to decrease. Business and personal planning will be made easier as the law becomes more stable.

At the same time, the merger of the courts will relieve docket pressures both on the regional appellate courts and on the Supreme Court. Although the number of appeals to be redirected is not great in proportion to the total caseload of these courts, the cases that will be rerouted contain some of the most complex and time-consuming issues the courts consider. The impact of the new court on the dockets of
these courts therefore will be fa
greater than the raw numbers migh
indicate. Thus, the proposed cou
will increase the capacity of the fed
eral judicial system for definitive ad
judication of patent and other issue
falling within its jurisdiction.

STATEMENT

During the 95th, 96th, and 97t
Congresses, the committee—actin
through the Subcommittee on Court
Civil Liberties and the Administratio
of Justice—has held extensive hearing
on the need of the Federal judicial sy
tem to keep up with societal and tech
nological change.[30]

Generally, there have been two fo
cal points to the subcommittee's hea
ings. First, extensive testimony ha
been received on the ever increasin
problems of the Federal courts and o
those individuals who litigate in them
Second, the subcommittee inquire
deeply into technological innovatio
as an element of productivity in th
American marketplace.

## [28] 95TH CONGRESS

Shortly after the beginning of th
95th Congress the subcommittee hel
general oversight hearings on the Stat
of the Judiciary and Access to Justice
Seven days of hearings were conducte
(on June 20, 22, and 29, July 21, 2
28, and 29, 1977). The hearings pro
duced excellent testimony from i
lustrious legal scholars. During the
hearings, several witnesses, includin
Attorney General Griffin B. Bell fo
the Carter Administration, Honorab
Robert A. Ainsworth, Jr. for the Jud
cial Conference of the United State
Prof. A. Leo Levin, former Executiv
Director of the Commission on Rev
sion of the Federal Appellate Syste
and present Director of the Federal J
dicial Center, Honorable Shirley Hu
stedler, for the American Bar Associ

---

[29] Article III, section 1, of the Constitution explicitly empowers the Congress to ordain and establish inferior courts. Consequently, the only questions concern the relation between the power of Congress, under Article I, section 8, cl. 18, of the Constitution to alter, enlarge, or restrict the functions of existing federal officers and the requirement of the Appointments Clause, Article II, section 2, cl. 2, that appointments as officers of the United States be made in the manner prescribed by that clause. Stated differently, this involves a reconciliation of the Supreme Court's decisions in *Shoemaker* v. *United States*, 147 U.S. 282, 301 (1893), and *Buckley* v. *Valeo*, 424 U.S. 1, 118-36 (1976). The earlier case stated the principle that Congress may, by statute, confer new duties on officers of the United States, at least where the new duties are "germane" to their existing functions, without the necessity of reappointment under the Appointments Clause. The latter holds that Congress may not itself appoint officers of the United States.

The Committee has concluded that the five-year carry-over of the trial commissioners into the Claims Court is a modification of an existing position rather than a legislative appointment to a new one, governed by *Buckley*. The bill merely would confer "germane" new duties and extend the tenure of the existing trial commissioners as permitted by *Shoemaker*, rather than create a new office.

[30] In this regard, one witness before the su
committee has eloquently stated: Today, too,
must be willing to recognize the need for pr
dent change. We can no longer afford to
satisfied with a structure unable to meet t
needs of today and tomorrow no matter ho
grateful we may be that it has worked well in t
past. The demands of a developing society, a
the needs of a judicial system which must r
spond effectively to continued growth, requi
no less. House Hearings on the State of the J
diciary, *supra* note 3, at 226 (statement of
Leo Levin).

tion, and former Solicitor General Robert Bork, addressed their thoughts to the pressing problems in the Federal appellate courts and to the need for various court reform proposals.

96TH CONGRESS

During the 96th Congress, the subcommittee received further evidence on the specific legislative proposals pending before it. As relates specifically to the court reform aspect of the proposal to create a Court of Appeals for the Federal Circuit, testimony was received from Chief Judge Howard T. Markey, U.S. Court of Customs and Patent Appeals; Chief Judge Daniel M. Friedman, U.S. Court of Claims; Honorable Maurice Rosenberg, Assistant Attorney General, U.S. Department of Justice; Donald Dunner, Esq., President, American Patent Law Association; and Benjamin Zelenko, Esq., and George Whitney, Esq., American Bar Association. The majority of these witnesses supported merging the Court of Claims and Court of Customs and Patent Appeals into a single court.

During the 96th Congress, there also was a second focal point to the subcommittee hearings. That was into industrial innovation as a key to increased productivity in the United States. Special emphasis was placed on the role of this country's patent system and patent policy regarding government funded research in promoting industrial innovation.

In this regard the Subcommittee on Courts, Civil Liberties and the Administration of Justice held a total of seven days of hearings (on April 3, 15, 17, 22, and 24, May 8, and June 9, 1980). Testimony was received from over 30 witnesses from Government, the private bar, industry, academic, small and corporate business, and the judiciary on pending legislation. Ultimately much of the substantive patent law legislation was enacted into law. *See* Public Law 96-517, 94 Stat. 3015 (96th Cong., 2d Sess. 1980).

As pertains to the proposal to create a Court of Appeals for the Federal Circuit (H.R. 3806), on August 26, 1980, this committee ordered the bill reported favorably by voice vote. See H. Rept. No. 96-1300, 96th Cong., 1st Sess. (1980).

On September 15, 1981, the 96th Congress bill went to the House floor on the suspension calendar. It was approved unanimously by voice vote.[31]

[29] The bill was held at the Senate desk and called up on Sept. 30, 1980. Due to an imminent threat to add a non-germane amendment relating to judicial review of regulatory actions (the "Bumpers Amendment"), the bill was withdrawn. When resolution of the Bumpers Amendment proved impossible, the bill was never rescheduled by the Senate leadership.

97TH CONGRESS

During the 97th Congress, the subcommittee held two more days of hearings on the legislation (H.R. 2405). These hearings were held on April 2 and 8, 1981. Testimony again was received from a diverse group of witnesses and organizations. Some had testified previously (including Chief Judge Markey, Chief Judge Friedman, the American Bar Association (through a new witness—James Geriak, Esq.); the American Patent Law Association (also through a new witness: Julius J. Jancin, Jr., Esq.). In addition, testimony was received from the Committee to Preserve the Patent Jurisdiction of the U.S. Courts of Appeals (Sidney Neuman, Esq., and Benjamin Zelenko, Esq., who had previously testified for the American Bar Association during the 96th Congress); the Industrial Research Institute, Inc. (Richard C. Witte, Esq.); Pauline Newman, Esq. (FMC Corporation Chemical Group); and Donald Banner, Esq. (former Commissioner of Patents). Written statements were received from approximately fifty individuals, organizations, bar associations, government entities, and businesses, including the Departments of Justice and Commerce, the Bar Association of the Seventh Circuit, the Bar Association of the District of Columbia, the Chemical Manufacturers Association and the American Chemical Society.

H.R. 2405 was marked up in two days. General debate was held on May 7, 1981; and actual markup occurred on September 10, 1981. Five minor amendments passed.[32] And then, a quorum of subcommittee Members being present, the bill was reported unanimously by voice vote in the form of a clean bill (H.R. 4482).

[30] On October 15, 1981, the full committee considered H.R. 4482, and after general debate, a quorum of members being present ordered the bill reported favorably by voice vote.[33]

---

[31] During the 96th Congress, the Senate also devoted considerable time and resources to federal appellate court improvements. Seven days of hearings were held on various proposals relating to improvements in judicial machinery, as embodied in S. 677 and S. 678. The original bills were revised and embodied in a new omnibus bill (S. 1477), which then passed the Senate on October 30, 1979. Title III of S. 1477 was the counterpart legislation to H.R. 3806 (*see* S. Rept. No. 96-304, 96th Cong., 1st Sess. (1979). *See* Hearings on Federal Courts Improvements Act of 1979 before the Senate Judiciary Subcommittee on Improvements in Judicial Machinery, 96th Cong., 1st Sess. (1979); *see also* Addendum to hearings on Federal Courts Improvement Act of 1979 before the Senate Judiciary Subcommittee on Improvements in Judicial Machinery, 96th Cong., 1st Sess. (1979).

[32] Basically, the subcommittee amendments were technical and clarifying in nature. The amendments were as follows:

Amendment 1. During the 96th Congress, it was determined by amendment that the first chief judge of the Court of Appeals for the Federal Circuit should be the chief judge senior in commission of the merged courts. At that time, it was left unclear as to what should be the seniority perquisites of the junior chief judge. The subcommittee amendment merely clarified that the junior judge should be deemed senior on commission over all the circuit judges on the court, other than the chief judge.

Amendment 2. Changed the effective date from October 1, 1981 to October 1, 1982. In addition, the amendment set forth a more detailed explanation of the Act's effect on pending cases.

Amendment 3. Was a technical amendment to correct minor drafting errors in the bill and to conform it to several pieces of legislation passed by the 96th Congress, including the Court of International Trade legislation.

Amendment 4. Required that the Court of Appeals for the Federal Circuit—in authorizing the hearing and determination of cases in panels—shall by rule ensure that all the judges sit on a representative cross section of all the cases heard. The second prong of the amendment indicated the sense of Congress to the President that he select for nomination to the Court of Appeals for the Federal Circuit and the Claims Court individuals who possess a broad range of professional expertise.

Amendment 5. Restored a provision of existing law that permits a judge of the Claims Court to require a plaintiff to appear before him to be examined under oath as to all matters pertaining to his claim.

[33] One amendment was unanimously approved by the full committee. Offered by Mr. Railsback, on behalf of the Administration, the amendment limited the ability of the new Claims Court to order injunctive and declaratory relief to contract actions prior to award.

Part III. Administrative, Procedural, and Miscellaneous

CONTENTS

Delegation Order No. 4 (Rev. 13) **331**
Delegation Order No. 5 (Rev. 10) **332**
Delegation Order No. 8 (Rev. 8) **333**
Delegation Order No. 11 (Rev. 13) **333**
Delegation Order No. 14 (Rev. 2) **333**
Delegation Order No. 35 (Rev. 12) **334**
Delegation Order No. 42 (Rev. 15) **334**
Delegation Order No. 42 (Rev. 16) **334**
Delegation Order No. 57 (Rev. 5) **335**
Delegation Order No. 77 (Rev. 15) **335**
Delegation Order No. 88 (Rev. 6) **335**
Delegation Order No. 93 (Rev. 8) **336**
Delegation Order No. 96 (Rev. 6) **336**
Delegation Order No. 97 (Rev. 19) **337**
Delegation Order No. 100 (Rev. 3) **338**
Delegation Order No. 107 (Rev. 6) **339**
Delegation Order No. 109 (Rev. 6) **339**
Delegation Order No. 112 (Rev. 7) **339**
Delegation Order No. 113 (Rev. 7) **340**
Delegation Order No. 114 (Rev. 3) **341**
Delegation Order No. 116 (Rev. 5) **341**
Delegation Order No. 130 (Rev. 2) **341**
Delegation Order No. 136 (Rev. 4) **341**
Delegation Order No. 139 (Rev. 6) **342**
Delegation Order No. 143 (Rev. 1) **342**
Delegation Order No. 144 (Rev. 1) **342**
Delegation Order No. 154 (Rev. 1) **342**
Delegation Order No. 155 (Rev. 1) **342**
Delegation Order No. 156 (Rev. 2) **343**
Delegation Order No. 156 (Rev. 2), Amendment 1 **349**
Delegation Order No. 157 (Rev. 3) **350**
Delegation Order No. 160 (Rev. 3) **350**
Delegation Order No. 182 (Rev. 1) **350**
Delegation Order No. 190 **350**
Delegation Order No. 191 **352**
Executive Order 12359 **352**
Notice 82-1 **353**
Notice 82-2 **353**
Notice 82-3 **353**
Notice 82-4 **356**
Notice 82-5 **356**
Notice 82-6 **356**
Notice 82-7 **356**
Notice 82-8 **357**
Notice 82-9 **358**
Notice 82-10 **359**
Notice 82-11 **359**
Notice 82-12 **359**
Notice 82-13 **360**
Notice 82-14 **366**
Revenue Procedure 82-1 **366**
Revenue Procedure 82-2 **367**
Revenue Procedure 82-3 **368**
Revenue Procedure 82-4 **380**
Revenue Procedure 82-5 **406**
Revenue Procedure 82-6 **409**
Revenue Procedure 82-7 **410**
Revenue Procedure 82-8 **413**
Revenue Procedure 82-9 **413**
Revenue Procedure 82-10 **414**
Revenue Procedure 82-11 **429**
Revenue Procedure 82-12 **429**
Revenue Procedure 82-13 **447**
Revenue Procedure 82-14 **459**
Revenue Procedure 82-15 **460**
Revenue Procedure 82-16 **461**
Revenue Procedure 82-17 **462**
Revenue Procedure 82-18 **463**
Revenue Procedure 82-19 **463**
Revenue Procedure 82-20 **466**
Revenue Procedure 82-21 **468**
Revenue Procedure 82-22 **469**
Revenue Procedure 82-23 **474**
Revenue Procedure 82-24 **474**
Revenue Procedure 82-25 **475**
Revenue Procedure 82-26 **476**
Revenue Procedure 82-27 **480**
Revenue Procedure 82-28 **480**
Revenue Procedure 82-29 **481**
Revenue Procedure 82-30 **485**
Revenue Procedure 82-31 **486**
Revenue Procedure 82-32 **486**
Revenue Procedure 82-33 **489**
Revenue Procedure 82-34 **489**
Revenue Procedure 82-35 **489**
Revenue Procedure 82-36 **490**
Revenue Procedure 82-37 **491**
Revenue Procedure 82-38 **503**
Treasury Department Order No. 150-95 **510**
Treasury Department Order No. 150-96 **511**

Delegation Order 4 (Rev. 13)
(Effective March 21, 1982)

Authority to Issue Summonses, to Administer Oaths and Certify, and to Perform Other Functions

1(a). The authorities granted to the Commissioner of Internal Revenue by 26 CFR 301.7602-1(b), 301.7603-1, 301.7604-1, and 301.7605-1(a) and the authorities contained in section 7609 of the Internal Revenue Code of 1954 and vested in the Commissioner of Internal Revenue Service by Treasury Department Order No. 150-37 to issue summonses; to set the time and place for appearance; to serve summonses; to take testimony under oath of the person summoned; to receive and examine books, papers, records or other data produced in compliance with the summons; to enforce summonses; to apply for court orders, approving the service of John Doe Summonses issued under section 7609(f) of the Internal Revenue Code; and to apply for court orders suspending the notice requirements in the case of summonses issued under section 7609(g) of the Internal Revenue Code, are delegated to the officers and employees of the Internal Revenue Service specified in paragraphs 1(b), 1(c), and 1(d) of this Order and subject to the limitations stated in paragraphs 1(b), 1(c), 1(d), and 6 of this Order.

(b) The authorities to issue summonses and to perform the other functions related thereto specified in paragraph 1(a) of this Order, are delegated to all District Directors and the following officers and employees, provided that the authority to issue a summons in which the proper name or names of the taxpayer or taxpayers is not identified because unknown or unidentifiable (hereinafter called a "John Doe" summons) may be exercised only by said officers and employees and by them only after obtaining preissuance legal review by Regional Counsel, Deputy Regional Counsel (General Litigation) or District Counsel, or the Director, General Litigation Division in the case of Inspection.

(1) Inspection: Assistant Commissioner and Director, Internal Security Division.

(2) District Criminal Investigation: Chief of Division, except this authority in streamlined districts is limited to the District Director.

(3) District Collection Activity: Chief of Division, except this authority in streamlined districts is limited to the District Director.

(4) District Examination: Chief of Division, except this authority in streamlined districts is limited to the District Director.

(5) District Employee Plans and Exempt Organizations: Chief of Division.

(c) The authorities to issue summonses except "John Doe" summonses, and to perform other functions related thereto specified in paragraph 1(a) of this Order, are delegated to the following officers and employees:

(1) Inspection: Regional Inspectors and Assistant Regional Inspectors (Internal Security) and Chief, Investigations Branch.

(2) District Criminal Investigation: Assistant Chief of Division; Chiefs of Branches; and Group Managers.

(3) District Collection Activity: Assistant Chief of Division; Chiefs of Collection Section; Chiefs of Field Branches and Office Branches; Chiefs, Special Procedures Staffs; Chiefs Technical and Office Compliance Branches and Groups and Group Managers.

(4) District Examination: Chiefs of Branches, Case Managers, Group Managers and, in streamlined districts Chiefs, Examination Section.

(5) District Employee Plans and Exempt Organizations: Group Managers.

(d) The authority to issue summonses except "John Doe" summonses and to perform the other functions related thereto specified in paragraph 1(a) of this Order is delegated to the following officers and employees except that in the instance of a summons to a third party witness, the issuing officer's case manager, group manager, or any supervisory official above that level, has in advance personally authorized the issuance of the summons. Such authorization shall be manifested by the signature of the authorizing officer on the face of the original and all copies of the summons or by a statement on the face of the original and all copies of the summons, signed by the issuing officer, that he/she had prior authorization to issue said summons and stating the name and title of the authorizing official and the date of authorization.

(1) Foreign Operations District: Internal Revenue Agents; Attorneys, Estate Tax; Estate Tax Examiners; Special Agents; Revenue Service and Assistant Revenue Service Representatives; Tax Auditors; and Revenue Officers, GS-9 and above.

(2) District Criminal Investigation: Special Agents.

(3) District Collection: Revenue Officers, GS-9 and above.

(4) District Examination: Internal Revenue Agents; Tax Auditors; Attorneys, Estate Tax; and Estate Tax Examiners.

(5) District Employee Plans and Exempt Organizations: Internal Revenue Agents; Tax Law Specialists; and Tax Auditors.

(e) Each of the officers and employees referred to in paragraphs 1(b), 1(c) and 1(d) of this Order may serve a summons whether it is issued by him/her or another official.

(f) Revenue Representatives, GS-5 and above, and Revenue Officers, who are assigned to the District Collection Activity and to International Operations may serve any summons issued by the officers and employees referred to in paragraphs 1(b), 1(c) and 1(d) of this Order.

2. Each of the officers and employees referred to in paragraphs 1(b), 1(c), and 1(d) of this Order authorized to issue summonses, is delegated the authority under 26 CFR 301.7602-1(b) to designate any other officer or employee of the Internal Revenue Service referred to in paragraph 4(b) of this Order, as the individual before whom a person summoned pursuant to section 7602 of the Internal Revenue Code shall appear. Any such other officer or employee of the Internal Revenue Service when so designated in a summons is authorized to take testimony under oath of the person summoned and to receive and examine books, papers, records or other data produced in compliance with the sum-

mons.

3. Internal Security Inspectors are delegated the authority under 26 CFR 301.7603-1 to serve summonses issued in accordance with this Order by any of the officers and employees of the Inspection Service referred to in paragraphs 1(b)(1) and 1(c)(1) of this Order even though Internal Security Inspectors do not have the authority to issue summonses.

4(a). The authorities granted to the Commissioner of Internal Revenue by 26 CFR 301.7602-1(a) and 301.7605-1(a) to examine books, papers, records or other data, to take testimony under oath and to set the time and place of examination are delegated to the officers and employees of the Internal Revenue Service specified in paragraphs 4(b), and 4(c) of this Order and subject to the limitations stated in paragraphs 4(c) and 6 of this Order.

(b) General Designations

(1) Inspection: Assistant Commissioner; Director Internal Security Division; Director, Internal Audit Division; Regional Inspectors; Internal Auditors; and Internal Security Inspectors; Investigators (Internal Security); and Internal Security Assistants.

(2) District Criminal Investigation: Chief and Assistant Chief of Division; Chiefs of Branches; Group Managers; and Special Agents.

(3) Foreign Operations District: Director, Assistant Director; Chief of Divisions and Branches; Special Agents; Case Managers; Group Managers, Internal Revenue Agents; Attorneys, Estate Tax; Estate Tax Examiners; Revenue Service and Assistant Revenue Service Representatives; Tax Auditors; and Revenue Officers.

(4) District Collection Activity: Chiefs and Assistant Chiefs of Division; Chiefs of Field Branches and Office Branches; Chiefs, Special Procedures Staffs; Chiefs, Technical and Office Compliance Branches; Chiefs, Collection Section; Chiefs, Technical and Office Compliance Branches and Groups; Group Managers; Revenue Officers; Revenue Representatives and Office Collection Representatives.

(5) District Examination: Chiefs of Division; Chiefs of Examination Sections; Chiefs of Examination Branches; Case Managers; Group Managers; Internal Revenue Agents; Tax Auditors; Attorneys, Estate Tax; and Estate Tax Examiners.

(6) District Employee Plans and Exempt Organization: Chief of Division; Chief, Examination Branch; Chief, Technical Staff; Group Managers; Internal Revenue Agents; Tax Law Specialists; and Tax Auditors.

(7) Service Center: Chief, Compliance Division; Chief, Examination Branch; Chief, Collection Branch; Chief, Criminal Investigation Branch; Revenue Agents; Tax Auditors; Tax Examiners in the correspondence examination function; and Special Agents.

(c) District Directors, Service Center Directors, Regional Inspectors, and the Chief of Investigation Branch may redelegate the authority under 4(a) of this Order to Law Clerks (Estate Tax), aides or trainees, respectively, for the positions of Revenue Agent, Tax Auditor, Tax Examiner in the Service Center Correspondence and Processing function, Tax Law Specialists, Revenue Officer, Internal Auditor, Internal Security Inspector, Investigator (Internal Security), Internal Security Assistant, Attorney (Estate Tax) and Special Agent, provided that each such Law Clerk (Estate Tax), aide or trainee shall exercise said authority only under the direct supervision, respectively, as applicable of a Revenue Agent, Tax Auditor, Tax Examiner in the Service Center Correspondence and Processing function, Tax Law Specialist Revenue Officer, Special Agent, Internal Auditor or Internal Security Inspector or Attorney (Estate Tax).

5. Under the authority granted to the Commissioner of Internal Revenue by 26 CFR 301.7622-1, the officers and employees of the Internal Revenue Service referred to in paragraphs 1(b), 1(c), 1(d), and 4(b) and 4(c) of this Order are designated to administer oaths and affirmations and to certify to such papers as may be necessary under the internal revenue laws and regulations *except* that the authority to certify shall not be construed as applying to those papers or documents the certification of which is authorized by separate order or directive. Revenue Representatives and Office Collection Representatives referred to in paragraph 4(b)(4) of this Order are not designated to administer oaths or to perform the other functions mentioned in this paragraph, except that Revenue Representatives, GS-5 and above, are authorized to certify the method and manner of service, and the method and manner of giving notice, when performing the functions and duties contained in paragraph 1(f) of this order.

6. The authority delegated herein may not be redelegated except as provided in paragraph 4(c).

7. This Order supersedes Delegation Order No. 4 (Rev. 12), issued April 28, 1981 [1981-2 C.B. 539].

JAMES OWENS,
Deputy Commissioner.

Delegation Order 5 (Rev. 10) (Effective March 21, 1982)

Emergency Order of Succession and Delegation of Authority

1. By virtue of the authority vested in me by Treasury Department Order No. 129, as revised, the officials in the positions listed below are hereby authorized, in the event of an enemy attack on the United States, and the disability of the Commissioner, his/her absence from the main Treasury Relocation Site, or if there is a vacancy in the office, to succeed to the position of Acting Commissioner in the order listed, and are authorized to perform the functions of Commissioner to insure the continuity of the functions of that office:

Deputy Commissioner
Associate Commissioner (Operations)
Associate Commissioner (Policy and Management)
Associate Commissioner (Data Processing)
Assistant Commissioner (Examination)
Assistant Commissioner (Collection)
Assistant Commissioner (Criminal Investigation)
Assistant Commissioner (Returns and Information Processing)
Assistant Commissioner (Planning, Finance and Research)
Assistant Commissioner (Support and Services)
Assistant Commissioner (Human Resources)

Assistant Commissioner (Inspection)
Assistant Commissioner (Employee Plans and Exempt Organization)
Assistant Commissioner (Computer Services)

2. If none of these officials is available, the first available Regional Commissioner, in the order of appointment as Regional Commissioner, will become Acting Commissioner.

3. If none of the officials listed in Paragraphs 1 and 2 is available, the first available District Director in the order shown on the list on file at each National Office Relocation Site (prepared on the basis of the higher ES grade first, date of promotion to the grade and alphabetical order where grade and promotion dates are identical) will assume the position of Acting Commissioner until relieved or further instructions are given by proper authority.

4. There is hereby delegated to Regional Commissioners and District Directors, or the officials acting in their stead, in the event of an enemy attack on the United States, all authority vested in the Commissioner of Internal Revenue by law or transfer from the Secretary of the Treasury to insure the continuous performance of Internal Revenue Service functions in their areas of jurisdiction. This delegation of authority will remain in effect until notice is received from proper authority that it has been terminated.

5. The authority delegated in Paragraphs 1, 2 and 3 may not be redelegated.

6. This Order supersedes Delegation Order No. 5 (Rev. 9), issued July 2, 1978 [1978-2 C.B. 466].

JAMES OWENS,
Deputy Commissioner.

Delegation Order 8 (Rev. 8)
(Effective March 21, 1982)

Authority to Sign Agreements as to Liability for Personal Holding Company Tax

1. The authority granted to the Commissioner of Internal Revenue and District Directors by 26 CFR 301.7701-9 and 26 CFR 1.547-2 to enter into agreements relating to liability for personal holding company tax, is hereby delegated to the following officials:

a. Chief Counsel
b. Regional Counsels
c. Regional Directors of Appeals;
d. Chiefs, Appeals Offices;
e. Associate Chiefs, Appeals Offices;
f. Assistant District Directors; and
g. Chiefs of District Examination Divisions, in other than streamlined districts.

2. This authority may be redelegated only by District Directors who may redelegate to the Chief of Review Staff; and to Revenue Agents (Reviewers) not lower than GS-11. In streamlined districts this authority may be redelegated only by the District Director who may redelegate not lower than to GS-11 Revenue Agents.

3. This Order supersedes Delegation Order No. 8 (Rev. 7), issued January 29, 1979 [1979-1 C.B. 473].

JAMES OWENS,
Deputy Commissioner.

Delegation Order 11 (Rev. 13)
(Effective March 21, 1982)

Authority to Accept or Reject Offers in Compromise

The authority vested in the Commissioner of Internal Revenue by Treasury Department Order Nos. 150-25 and 150-36 [1954-2 C.B. 733], 26 CFR 301.7122-1 and 26 CFR 301.7701-9, and Treasury Department Order No. 150-60 is hereby delegated as follows:

1. Regional Commissioners of Internal Revenue and Regional Counsels are delegated authority, under section 7122 of the Internal Revenue Code, to accept offers in compromise in cases in which the unpaid liability (including any interest, penalty, additional amount or addition to tax) is $100,000 or more. This authority does not pertain to offers in compromise of liabilities arising under laws relating to alcohol, tobacco and firearms taxes. This authority may not be redelegated.

2. District Directors, Assistant District Directors, Regional Counsels, Regional Directors of Appeals, Chiefs and Associate Chiefs, Appeals Offices, are delegated authority, under section 7122 of the Internal Revenue Code, to accept offers in compromise in cases in which the liability sought to be compromised (including any interest, penalty, additional amount or addition to tax) is less than $100,000, to accept offers involving specific penalties, and to reject offers in compromise regardless of the amount of the liability sought to be compromised. This authority does not pertain to offers in compromise of liabilities arising under laws relating to alcohol, tobacco, and firearms taxes. The authority delegated to District Directors and Assistant District Directors may not be redelegated, except that the authority to reject offers in compromise may be redelegated, but not lower than to Division Chief. The District Director in a streamlined district may not redelegate this authority. The Regional Counsels, Regional Director of Appeals, Chiefs and Associate Chiefs, Appeals Offices, may not redelegate this authority.

3. Service Center Directors and Assistant Service Center Directors are delegated authority, under section 7122 of the Internal Revenue Code, to accept offers in compromise, limited to penalties based solely on doubt as to liability, in cases in which the unpaid liability is less than $100,000, and to reject offers in compromise, limited to penalties, regardless of the amount of the liability sought to be compromised. This authority does not pertain to offers in compromise of liabilities arising under laws relating to alcohol, tobacco, and firearms taxes. This authority may be redelegated, but not lower than to Division Chief.

4. This Order supersedes Delegation Order No. 11 (Rev. 12) issued July 7, 1980 [1980-2 C.B. 754].

JAMES OWENS,
Deputy Commissioner.

Delegation Order 14 (Rev. 2)
(Effective March 21, 1982)

Granting Extension of Time for Filing Statements in Accordance with 26 CFR 1.534-2

1. Regional Counsels and Regional Commissioners are hereby authorized to delegate to appropriate officials authority to grant taxpayers an extension of time not in excess of thirty additional days for the purpose of filing the statement of grounds called for in registered mail notification sent pursuant to the authority vested in the Commissioner of Internal Revenue by 26 CFR 1.534-2.

2. This Order supersedes Delegation Order No. 14 (Rev. 1), issued October 1, 1978 [1978-2 C.B. 467].

JAMES OWENS,
Deputy Commissioner.

Delegation Order 35 (Rev. 12)
(Effective March 21, 1982)

Agreements as Determinations Under Section 1313(a)(4) of the Internal Revenue Code of 1954

1. Pursuant to the authority granted to the Commissioner of Internal Revenue and District Directors by 26 CFR 301.7701-9 and 26 CFR 1.1313(a)-4, the authority to enter into agreements pursuant to section 1313(a)(4), Internal Revenue Code of 1954, relating to agreements treated as determinations, is hereby delegated to the following officials:

a. Chief Counsel

b. Regional Counsels

c. Regional Directors of Appeals;

d. Chiefs and Associate Chiefs of Appeals Offices;

e. Appeals Team Chiefs as to their respective cases;

f. Assistant District Directors;

g. Chiefs of Examination Divisions; and

h. Chiefs of Employee Plans and Exempt Organizations Divisions.

2. In other than streamlined districts this authority may be redelegated only by District Directors, who may redelegate to the Chief of Review Staff; to Revenue Agents and Tax Law Specialists (Reviewers) not lower than GS-11 for field examination cases; and to Revenue Agents and Tax Technicians (Reviewers) not lower than GS-9 for office examination cases. In streamlined districts, this authority may be redelegated by the District Director no lower than to GS-11 Revenue Agents.

3. This Order supersedes Delegation Order No. 35 (Rev. 11), [1980-1 C.B. 571] issued February 28, 1980.

JAMES OWENS,
Deputy Commissioner.

Delegation Order 42 (Rev. 15)
(Effective January 11, 1982)

Authority to Execute Consents Fixing the Period of Limitations on Assessment or Collection

1. Pursuant to authority vested in the Commissioner of Internal Revenue by Treasury Department Order No. 120; Order No. 150-2; 26 CFR 301.6501(c)-1; 26 CFR 301.6502-1; 26 CFR 301.6901-1(d); and 26 CFR 301.7701-9; the authority to sign all consents fixing the period of limitations on assessment or collection is delegated to the following officials:

a. Regional Directors of Appeals;
b. Service Center Directors;
c. District Directors;
d. Director of International Operations.

2. This authority may be redelegated but not below the following levels for each activity:

a. Service Centers—Chief, Accounting Branch; Chief, Correspondence and Processing Section; Revenue Officers; and Chief, Quality Review Staff;
b. Collection—Chiefs, Office Branches and Office Groups; Revenue Officers; Chiefs, Technical and Office Compliance Branches and Groups; Revenue Representative Supervisors;
c. Examination—Reviewers, Grade GS-11; Group Managers; Case Managers; Returns Program Managers; and Classifiers/Screeners, Grade GS-11; Chief, Examination Support Staff/Section;
d. Criminal Investigation—Chiefs, Criminal Investigation Divisions, except this authority in streamlined districts is limited to the District Director;
e. Appeals—Appeals Officers;
f. Office of International Operations—Representatives at foreign posts; Revenue Agents, Tax Auditors, and Special Agents on foreign assignments; and levels b, c, and d, above; and
g. District Employee Plans and Exempt Organizations—Reviewers, Grade GS-11; Group Managers.

3. This Order supersedes Delegation Order No. 42 (Rev. 14), issued August 10, 1981 [46 F.R. 40969, August 13, 1981].

ROSCOE L. EGGER, JR.,
Commissioner.

(Filed by the Office of the Federal Register on January 14, 1982, 8:45 a.m., and published in the issue of the Federal Register for January 15,1982, 47 F.R. 2449)

Delegation Order 42 (Rev. 16)
(Effective March 21, 1982)

Authority to Execute Consents Fixing the Period of Limitations on Assessment or Collection Under Provisions of the 1939 and 1954 Internal Revenue Codes

1. Pursuant to authority vested in the Commissioner of Internal Revenue by Treasury Department Order No. 120; Order No. 150-2; 26 CFR 301.6501(c)-1; 26 CFR 301.6502-1; 26 CFR 301.6901-1(d); and 26 CFR 301.7701-9; the authority to sign all consents fixing the period of limitations on assessment or collection is delegated to the following officials:

a. Chief Counsel

b. Regional Counsels

c. Regional Directors of Appeals

d. Service Center Directors

e. District Directors

2. This authority may be redelegated but not below the following levels for each activity:

a. Service Centers—Chief, Accounting Branch; Chief, Correspondence and Processing Section; Revenue Officers; and Chief, Quality Review Staff;

b. Collection—Chiefs, Office Branches and Office Groups; Revenue Officers; Chiefs, Technical and Office Compliance Branches and Groups; Revenue Representative Supervisors;

c. Examination—Reviewers, Grade GS-11; Group Managers; Case Managers; Returns Program Managers; and Classifiers/Screeners, Grade GS-11; Chief, Examination Support Staff/Section;

d. Criminal Investigation—Chiefs, Criminal Investigation Divisions, except this authority in streamlined districts is limited to the District Director;

e. Appeals—Appeal Officers;

f. Foreign Operations District—Representatives at foreign posts; Revenue Agents, Tax Auditors, and Special Agents on foreign assignments; and levels b, c, and d, above; and

g. District Employee Plans and Exempt Organizations—Reviewers, Grade GS-11; Group Managers.

3. No authority is delegated under this Order to the District Counsel.

4. This Order supersedes Delegation Order No. 42 (Rev. 15), [page 334, this Bulletin] issued January 11, 1982.

JAMES OWENS,
Deputy Commissioner.

Delegation Order 57 (Rev. 5) (Effective March 21, 1982)

Notice of Additional Inspection of Taxpayer's Books of Account Under Section 7605(b), Internal Revenue Code of 1954

Pursuant to the provisions of section 7851(b)(3) of the Internal Revenue Code of 1954, there is hereby delegated to each District Director and Service Center Director, the authority to sign in his/her name, after investigation, on the notice to a taxpayer, required by section 7605(b) of the Internal Revenue Code of 1954, that an additional inspection of such taxpayer's books of account is necessary.

This authority may not be redelegated.

This Order supersedes Delegation Order No. 57 (Rev. 4) [1980-1 C.B. 571] issued February 20, 1980.

JAMES OWENS,
Deputy Commissioner.

Delegation Order 77 (Rev. 15) (Effective March 21, 1982)

Authority to Issue Statutory Notices of Deficiency

1. The authority granted to the Commissioner of Internal Revenue and District Directors, by 26 CFR 301.7701-9, 26 CFR 301.6212-1, and 26 CFR 301.6861-1 to sign and send to the taxpayer by registered or certified mail any statutory notice of deficiency is hereby delegated to the following officials:

a. Chief Counsel
b. Regional Counsels
c. Regional Directors of Appeals;
d. Chiefs and Associate Chiefs of Appeals Offices;
e. Appeals Team Chiefs as to their respective cases;
f. Service Center Directors;
g. Assistant District Directors;
h. Assistant Service Center Directors;
i. Chiefs of Examination Divisions;
j. Chiefs of Correspondence and Processing Sections; and
k. Chiefs of Employee Plans and Exempt Organizations Divisions.

2. This authority may be redelegated only by District Directors and Service Center Directors but not lower than Reviewers, Grade GS-9 in the Examination Division, Revenue Agents (GS-11) in streamlined district Examination Sections and/or groups, Examination Tax Examiners (Reviewers, GS-6) in Service Center Compliance Divisions, and Reviewers, Grade GS-12, in Employee Plans and Exempt Organizations Divisions.

3. This Order supersedes Delegation Order No. 77 (Rev. 14) [1980-1 C.B. 573], February 28, 1980.

JAMES OWENS,
Deputy Commissioner.

Delegation Order 88 (Rev. 6) (Effective March 31, 1982)

Issuance of Notices of Revocation and Reestablishment of Exemption

1. Pursuant to the provisions of 26 CFR 1.503(a)-1 and Treasury Department Order 150-37, the authority vested in the Commissioner of Internal Revenue to determine that any organization or trust described in section 401(a) which is referred to in section 4975(g)(2) or (3) or any trust described in section 501(c)(17) or 501(c)(18) has engaged in a prohibited transaction and to notify such entity in writing of the revocation of exemption is delegated to the District Director of each of the following Employee Plans and Exempt Organizations Key Districts.

Key Districts and IRS District Covered

Central Region
Cincinnati—Cincinnati, Louisville and Indianapolis
Cleveland—Cleveland and Parkersburg Detroit—Detroit
Mid-Atlantic Region
Baltimore—Baltimore, Pittsburgh, Richmond and Foreign Operations
Newark—Newark, Philadelphia and Wilmington
Midwest Region
Chicago—Chicago
St. Paul—St. Paul, Aberdeen, Fargo and Milwaukee
St. Louis—St. Louis, Des Moines, Omaha and Springfield
North-Atlantic Region
Boston—Boston, Augusta, Burlington, Providence, Hartford and Portsmouth
Manhattan—Manhattan
Brooklyn—Brooklyn, Albany and Buffalo
Southeast Region
Atlanta—Atlanta, Birmingham, Columbia, Greensboro, Jackson, Jacksonville and Nashville
Southwest Region
Dallas—Dallas, Houston, Albuquerque, Austin, Cheyenne, Denver, Little Rock, New Orleans, Oklahoma City and Wichita
Western Region
Los Angeles—Los Angeles, Phoenix and Honolulu
San Francisco—San Francisco, Reno and Salt Lake City
Seattle—Seattle, Portland, Anchorage, Boise and Helena

2. Such Key District Directors are also delegated authority to determine that such organizations and trusts will not knowingly again engage in a prohibited transaction and that they also satisfy all other requirements under section 501(c)(17), 501(c)(18) or ap-

plicable requirements of section 401(a) of the Internal Revenue Code of 1954 and to notify such trust or organization in writing of the reestablishment of its exemption pursuant to 26 CFR 1.503(c)(1).

3. The authority delegated in this order may be redelegated but not below Chief, Employee Plans and Exempt Organizations Division.

4. This order supersedes Delegation Order No. 88 (Rev. 5) issued January 12, 1981 [1981-1 C.B. 609].

James I. Owens,
Deputy Commissioner.

(Filed by the Office of the Federal Register on April 13, 1982, 8:45 a.m., and published in the issue of the Federal Register for April 14, 1982, 47 F.R. 16131)

Delegation Order 93 (Rev. 8) (Effective March 21, 1982)

Authority to Consent to a Redetermination of Aggregations by a Taxpayer in the Case of Invalid Basic Aggregations or Invalid Additions

1. The authority vested in the Commissioner of Internal Revenue as prescribed in 26 CFR 1.614-2(d)(5) and 26 CFR 1.614-3(f)(8) and described below is hereby delegated to Chief Counsel, Regional Counsels, Regional Directors of Appeals, Chiefs and Associate Chiefs of Appeals Offices, Appeals Team Chiefs as to their respective cases, District Directors, and in other than streamlined districts, Chiefs, District Examination Divisions. In streamlined districts, this authority is not delegated below the District Director.

Consent to the reforming of aggregations by a taxpayer where the taxpayer has formed invalid basic aggregations or made invalid additions to valid or invalid basic aggregations, and

Consent, in the case of oil and gas wells where an invalid aggregation has been formed under section 614(b), to the treatment by a taxpayer of all the properties included in the aggregation, which fall within a single operating unit, under the provisions of section 614(d) rather than section 614(b) of the 1954 Code if so requested by the taxpayer.

2. In the case of oil and gas wells this delegation order shall apply only to taxable years subject to the 1954 Code beginning before January 1, 1964.

3. The authority delegated herein may not be redelegated.

4. This Order supersedes Delegation Order No. 93 (Rev. 7), [1980-1 C.B. 573] issued February 28, 1980.

James Owens,
Deputy Commissioner.

Delegation Order 96 (Rev. 6) (Effective March 21, 1982)

Application of Rulings Without Retroactive Effect

1. Pursuant to authority granted to the Commissioner of Internal Revenue by 26 CFR 301.7805-1(b):

a. the Associate Chief Counsel (Technical) and the Deputy Associate Chief Counsel (Technical) are hereby authorized to prescribe the extent, if any, to which any ruling issued by or pursuant to authorization from the Chief Counsel relating to the internal revenue laws shall be applied without retroactive effect.

b. the Assistant Commissioner (Employee Plans and Exempt Organizations) and the Deputy Assistant Commissioner (Employee Plans and Exempt Organizations) are hereby authorized to prescribe the extent, if any, to which any ruling issued by or pursuant to authorization from the Assistant Commissioner relating to the internal revenue laws shall be applied without retroactive effect.

2. a. Pursuant to authority granted to the Commissioner of Internal Revenue by 26 CFR 301.7805-1(b), there is hereby delegated to the Director, Employee Plans Division and to the Director, Actuarial Division of the National Office, and to the Director of each EP/EO Key District, the authority to limit the retroactive effect of the revocation of any determination letter issued with respect to employee plans if the following conditions are met:

(1) The plan sponsor has received a favorable determination letter under the law in effect prior to the date that the Employee Retirement Income Security Act of 1974 [Pub. L. 93-406, 1974-3 C.B. 1] (ERISA) applied to the plan, but did not receive a favorable post-ERISA determination letter.

(2) The plan sponsor executed the necessary plan amendments to conform to ERISA retroactively to the first plan year that was subject to ERISA and such amendments are executed no later than 91 days after the issuance of a final determination letter or notice of amendments needed to effect compliance (which notice shall be issued at least 91 days prior to the final examination report).

(3) Employees' and beneficiaries' rights and/or benefits under the plan are restored to levels they would have had to attain if the plan had never failed to qualify under ERISA.

(4) The requirements of section 2b relating to form are satisfied on June 4, 1980, and the requirements of section 2b relating to operation are met beginning with the ERISA effective date for the minimum participation standards determined wiht regard to each plan.

b. The requirements of this section are:

(1) The plan satisfies the age and service requirements for participation described in section 410(a) of the Code or fails to satisfy such requirements solely because the plan incorrectly credits service for eligibility purposes;

(2) The plan satisfies the requirements of section 411(a) or fails to satisfy such requirements solely because the plan incorrectly credits service for vesting purposes;

(3) In the case of a plan subject to the joint and survivor requirements of section 401(a)(11) such plan provides a joint and survivor annuity;

(4) The plan has not failed to satisfy the requirements of section 414(1);

(5) The plan has not, in operation, violated the limitations of section 415(c) by making excess allocations to individuals who are officers, shareholders or highly compensated; and

(6) The plan has not, in operation, been discriminatory in coverage or in contributions or benefits under sections 410(b) and 401(a)(4).

c. In the case of a plan that fails to satisfy section 2a solely as a result of not satisfying one or more of the requirements of section 2b, partial relief will be granted through section

7805(b). The employer's contributions will not be deductible as contributions to a qualified plan. However, section 7805(b) relief will be applied to the trust and all employees except to the extent described in the next two sentences. In the case of a plan that does not satisfy section 2b(5), the 7805(b) relief described in the previous sentence will not apply to any officer, shareholder, or highly compensated individual who received annual additions that did not satisfy such section. In the case of a plan which does not satisfy section 2b(6), the 7805(b) relief will not apply to any officer, shareholder or highly compensated individual. Thus, any such officer, shareholder or highly compensated individual will not receive the tax treatment applicable with respect to qualified plans. In the case of a plan which fails to satisfy applicable requirements for any other reason relief can only be granted pursuant to section 1b.

d. The section 7805(b) relief detailed in sections 2a, 2c and 3 shall be effective for the period beginning with the ERISA effective date for the minimum participation standards determined with regard to each plan and ending on the date of final compliance which shall be no later than the date defined in section 2a(2) of this order.

e. In determining whether the requirements of this section are satisfied, proposed amendments received by the Service by June 4, 1980, will be taken into account.

3. a. In addition to the authority delegated in section 2 above, there is delegated to the Director of each EP/EO Key District, the Director, Employee Plans Division and the Director, Actuarial Division, the authority to limit the retroactive effect of the revocation, if any, of a favorable post-ERISA determination letter issued for a plan, except issues with respect to which an Alert Guidelines worksheet was completed. If a determination letter was issued erroneously with respect to issues covered by a completed Alert Guidelines worksheet, retroactive relief may only be granted pursuant to section 1b.

b. If a plan described in section 3a is amended in accordance with section 2a(2), restoration will be required and relief will be granted to the extent described below. If the defect did not exist at the time of the prior letter, the sponsor must restore any benefits and relief will be granted in accordance with the principles in section 2c for the period in which the defect existed. If the defect did exist at the time of the prior letter, the related benefits need only be restored for the period during which the plan was, without regard to the defect, not in compliance with Code section 401(a), and full section 7805(b) relief wil be granted.

4. The delegation of authority granted pursuant to sections 2 and 3 above does not permit relief to be granted in any case if after September 30, 1982, amendments required for complete compliance have not been executed or a request for a determination letter with proposed ERISA amendments has not been filed. Notwithstanding the above, the Director of each EP/EO Key District is not delegated any section 7805(b) authority in the case of a plan which the Director of each EP/EO Key District determines to have been discriminatory for years before the effective date of section 410 for such plan. Cases described in this section must be referred to the National Office pursuant to procedures governing requests for technical advice.

5. Notwithstanding any of the above, section 7805(b) authority is not delegated to the Director, Employee Plans Division, the Director, Actuarial Division and the Director of each EP/EO Key District in the case of a plan which has been determined to have violated the exclusive benefit rule of section 401(a).

6. The section 7805(b) authority described in sections 2a, 2c or 3 will be exercised except in rare and unusual circumstances. Where rare and unusual circumstances exist, denial of section 7805(b) relief will be applied only if approved by the National Office.

7. The authority delegated in section 1 may not be redelegated.

8. The authority to grant 7805(b) relief in certain employee plan matters herein delegated to the Director, Employee Plans Division and to the Director of each EP/EO Key District may not be redelegated below the level of the Chief, Employee Plans Technical Branch and the Assistant Chief, EP/EO Division, respectively. The authority to grant 7805(b) relief delegated to the Director, Actuarial Division may not be redelegated.

9. This delegation order expires with respect to the Director of each EP/EO Key District on December 31, 1982.

10. This delegation order supersedes Delegation Order No. 96 (Rev. 5) [1981-2 C.B. 541] issued June 18, 1981.

JAMES OWENS,
Deputy Commissioner.

Delegation Order 97 (Rev. 19) (Effective March 21, 1982)

Closing Agreements Concerning Internal Revenue Tax Liability

Pursuant to authority granted to the Commissioner of Internal Revenue by 26 CFR 301.7121-(a); Treasury Department Order No. 150-32; Treasury Department Order No. 150-36; and Treasury Department Order No. 150-83, subject to the transfer of authority covered in Treasury Department Order No. 221, as modified by Treasury Department Order No. 221-3 (Rev. 2), as revised, this authority is hereinafter delegated.

1. The Chief Counsel is hereby authorized in cases under his/her jurisdiction to enter into and approve a written agreement with any person relating to the Internal Revenue tax liability of such person (or of the person or estate for whom he/she acts) in respect to any prospective transactions or completed transactions if the request to the Chief Counsel for determination or ruling was made before any affected returns have been filed.

2. The Assistant Commissioner (Examination) is hereby authorized to enter into and approve a written agreement with any person relating to the Internal Revenue tax liability of such person (or of the person or estate for whom he/she acts) for a taxable period or periods ended prior to the date of agreement and related specific items affecting other taxable periods. The Associate Commissioner (Operations) is also authorized to enter into

and approve a written agreement with any person relating to the Internal Revenue tax liability of such person (or of the person or estate for whom he/she acts) with respect to the performance of his/her functions as the competent authority under the tax conventions of the United States.

3. The Assistant Commissioner (Employee Plans and Exempt Organizations) is hereby authorized to enter into and approve a written agreement with any person relating to the Internal Revenue tax liability of such person (or of the person or estate for whom he/she acts) in cases under his/her jurisdiction, that is, in respect of any transaction concerning employee plans or exempt organizations.

4. Regional Commissioners; Regional Counsel; Regional Directors of Appeals; Assistant Regional Commissioners (Examination); District Directors; Chiefs and Associate Chiefs of Appeals Offices; and Appeals Team Chiefs with respect to his/her team cases, are hereby authorized in cases under their jurisdiction (but excluding cases docketed before the United States Tax Court) to enter into and approve a written agreement with any person relating to the Internal Revenue tax liability of such person (or of the person or estate for whom he/she acts) for a taxable period or periods ended prior to the date of agreement and related specific items affecting other taxable periods.

5. The Associate Chief Counsel (Technical); the Assistant Commissioner (Employee Plans and Exempt Organizations); Regional Commissioners; Regional Counsel; Regional Directors of Appeals; Chiefs and Associate Chiefs of Appeals Offices; and Appeals Team Chiefs with respect to his/her team cases, are hereby authorized in cases under their jurisdiction docketed in the United States Tax Court and in other Tax Court cases upon the request of Chief Counsel or his/her delegate to enter into and approve a written agreement with any person relating to the Internal Revenue tax liability of such person (or of the person or estate for whom he/she acts) but only in respect to related specific items affecting other taxable periods.

6. The Director, Foreign Operations District, is hereby authorized to enter into and approve a written agreement with any person relating to the Internal Revenue Tax liability of such person (or of the person or estate for whom he/she acts) to provide for the mitigation of economic double taxation under section 3 of Revenue Procedure 64-54, C.B. 1964-2, 1008, under Revenue Procedure 72-22, C.B. 1972-1, 747, and under Revenue Procedure 69-13, C.B. 1969-1, 402, and to enter into and approve a written agreement providing the treatment available under Revenue Procedure 65-17, C.B. 1965-1, 833.

7. The authority delegated herein does not include the authority to set aside any closing agreement.

8. Authority delegated in this Order may not be redelegated, except that the Chief Counsel may redelegate the authority contained in paragraph 1 to the Associate Chief Counsel (Technical) and to the technical advisors on the staff of the Associate Chief Counsel (Technical) for cases that do not involve precedent issues, the Assistant Commissioner (Examination) may redelegate the authority contained in paragraph 2 of this Order to the Deputy Assistant Commissioner (Examination), except that the authority relating to the performance of his/her functions as the competent authority under the tax conventions of the United States may not be redelegated; and the Assistant Commissioner (Employee Plans and Exempt Organizations) may redelegate the authority contained in paragraph 3 of this Order to the Deputy Assistant Commissioner (Employee Plans and Exempt Organizations) and to the Technical Advisors on the Staff of the Assistant Commissioner (Employee Plans and Exempt Organizations) for cases that do not involve precedent issues.

9. Delegation Order No. 97 (Rev. 18) [1980-1 C.B. 574], issued February 28, 1980, is hereby superseded.

JAMES OWENS,
Deputy Commissioner.

Delegation Order 100 (Rev. 3) (Effective March 21, 1982)

Furnishing Special Statistical Studies, Compilations, Return and Return Information, Training, and Training Aids

1. The authority to furnish information on a reimbursable basis, provided by 26 USC 6108 and delegated to the Commissioner of Internal Revenue by Treasury Department Order No. 150-37, is hereby redelegated to the Assistant Commissioner (Returns and Information Processing). Upon written request of any person and agreement by such person to pay the cost of the work or services to be performed, the Assistant Commissioner (Returns and Information Processing) is authorized to provide special statistical studies and compilations involving return information (as defined in 26 USC 6103(b)(2)). Whereas these special statistical studies and compilations may be derived from return information, they do not, in and of themselves, constitute return information. No publication or disclosure of statistics or other information authorized under this delegation shall permit the disclosure of any information that would be associated with or otherwise identify, directly or indirectly, a particular taxpayer. This authority may not be redelegated below the level of Division Director.

2. The authority to enter into contracts to furnish information on a reimbursable basis under 26 USC 6103, and delegated to the Commissioner of Internal Revenue by Treasury Department Order No. 150-37, is hereby redelegated to all Assistant Commissioners. Upon written request by any person and agreement by such person to pay the cost of work to be performed, the Assistant Commissioner having functional responsibility over the resources to be utilized in filling this request may authorize the providing of services or the furnishing of return and return information upon determination by the Commissioner or his/her delegate that information to be furnished is disclosable under 26 USC 6103. Any return or return information (as defined in 26 USC 6103(b)(1) and (2)) provided under this paragraph is subject to disclosure laws, regulations, and internal operating instructions covering 26 USC 6103. Joint authorization may be appropri-

ate if filling the request requires utilization of resources in more than one Assistant Commissioner area. This authority may not be redelegated below the level of Division Director or equivalent level position.

3. The authority delegated to the Commissioner of Internal Revenue by 26 CFR 301.7516-1 is hereby redelegated to the Assistant Commissioner (Human Resources), within his/her discretion, upon written request, to admit employees and officials of any State, the Commonwealth of Puerto Rico, any possession of the United States, any political subdivision or instrumentality of any of the foregoing, the District of Columbia, and foreign governments to training courses conducted by the Internal Revenue Service and to authorize that they be supplied with texts and other training aids. The Assistant Commissioner (Human Resources) may require payment of a reasonable fee not to exceed the cost of the training and training aids supplied pursuant to request from the party or parties making such requests. This authority may not be redelegated below the level of Division Director.

4. Delegation Order No. 100 (Rev. 2) [1978-2 C.B. 478], issued July 2, 1978, as superseded.

JAMES OWENS,
Deputy Commissioner.

Delegation Order 107 (Rev. 6) (Effective March 21, 1982)

Authority to Determine that Certain "Savings Institutions" do not Intend to Avoid Taxes by Paying Dividends or Interest for Periods Representing More than 12 Months

1. The authority granted to the Commissioner of Internal Revenue under 26 CFR 1.461-1(e)(3)(ii) to determine that an organization referred to therein does not intend to avoid taxes (and therefore be permitted to deduct one-tenth of the amount of dividends or interest not allowed as a deduction for a taxable year under 26 CFR 1.461-1(e)(1) in each of ten succeeding taxable years) is hereby delegated to the following officials:

a. Chief Counsel
b. Regional Counsels
c. Regional Directors of Appeals,
d. District Directors,
e. Chiefs, Appeals Offices,
f. Associate Chiefs, Appeals Offices,
g. Assistant District Directors, and
h. Chiefs of District Examination Divisions.

2. In nonstreamlined districts this authority may be redelegated only by District Directors, who may redelegate to the Chief of Review Staff. In streamlined districts, District Directors may redelegate this authority not lower than to GS-11 Revenue Agents.

3. This Order supersedes Delegation Order No. 107 (Rev. 5) [1979-1 C.B. 476], issued January 29, 1979.

JAMES OWENS,
Deputy Commissioner.

Delegation Order 109 (Rev. 6) (Effective March 21, 1982)

Authority to Sign Agreements Determining Inapplicability of Exclusion under Section 963 of Internal Revenue Code of 1954

1. The authority granted to the Commissioner of Internal Revenue and to District Directors by 26 CFR 301.7701-9 and 26 CFR 1.963-6(c) to sign agreements determining that the exclusion under section 963 of the Internal Revenue Code of 1954 does not apply to United States shareholders for certain taxable periods due to their failure to receive minimum distributions is hereby delegated to the following officials:

(a) Chief Counsel
(b) Regional Counsels
(c) Regional Directors of Appeals;
(d) District Directors;
(e) Chiefs, Appeals Offices;
(f) Associate Chiefs, Appeals Offices;
(g) Assistant District Directors; and
(h) Chiefs of District Examination Divisions

2. This authority may be redelegated only by District Directors, who may redelegate to the Chief of Review Staff. This authority may not be delegated below the District Director in streamlined districts.

3. This Order supersedes Delegation Order No. 109 (Rev. 5) [1979-1 C.B. 476], issued January 29, 1979.

JAMES OWENS,
Deputy Commissioner.

Delegation Order 112 (Rev. 7) (Effective March 21, 1982)

Authority to Issue Determination and Revocation Letters, to Grant Extension of the Remedial Amendment Period and to Issue Examination Reports Relating to Employee Plans

Pursuant to authority vested in the Commissioner of Internal Revenue by Treasury Department Order No. 150-37, authority with respect to issuance of determination and revocation letters, to granting extensions of the remedial amendment period and to issuance of examination reports pertaining to employee plans and related matters is delegated as follows:

1. The District Director of each Employee Plans and Exempt Organizations key district is authorized, subject to paragraph 3, to:

(a) issue determination and revocation letters involving the provisions of sections 401, 403(a), 405, 409A, 501(a), and 4975(e)(7) of the Internal Revenue Code of 1954 with respect to:

(1) qualification of stock bonus, pension, profit sharing, employee stock ownership, annuity, and bond purchase plans, and cash or deferred arrangements;

(2) exemption from federal income tax under section 501(a) of trusts forming a part of such plans, provided that the determination does not involve application of section 502 (feeder organizations) or section 511 (unrelated business income), or the question of whether a proposed transaction will be a prohibited transaction under section 4975(c)(1) or section 503 with respect to plans described in 4975(g)(2) or (3);

(3) compliance with the applicable requirements of foreign situs trusts as to taxability of beneficiaries (section 402(c)) and deductions for employer contributions (section 404(a)(4)); and

(4) amendments, (including those relating to section 414(1) of the Code), partial terminations or terminations of such plans and trusts.

(b) issue examination reports with respect to:

(1) continued qualification under sections 401, 403(a), 405, 409A, and 4975(e)(7) of plans and continued exemption under section 501(a) of the related trust;

(2) imposition of tax under sections 1, 511 through 514, 641 and Chapter 43; and

(3) imposition of penalties under Chapter 68 of the Internal Revenue Code of 1954.

(c) issue determination letters with respect to whether a plan constitutes an employee stock ownership plan that is not intended to qualify under section 401 of the Internal Revenue Code of 1954 for taxable years beginning before January 1, 1979.

(d) issue modification or revocation of determination letters described above in accordance with currently applicable appeal procedures. If the revocation involves collectively-bargained plans, or plans for which the Internal Revenue Service is proposing to issue a revocation letter because certain fiduciary actions subject to Part 4, Subtitle B of Title I of the Employee Retirement Income Security Act (ERISA) have violated the exclusive benefit rule of section 401(a), the plan must have been submitted for technical advice and the Assistant Commissioner (E) must have concurred with the revocation.

(e) redelegate this authority as follows:

(1) with respect to issuance and modification of favorable determination letters or examination reports, other than a report issued with a proposed revocation letter, not below Internal Revenue Agent and Tax Law Specialist, GS-12, and then only if such individual is a person other than the initiator.

(2) with respect to issuance of proposed and final adverse determination letters or proposed revocation letters and related examination reports, not below Chief, EP/EO Division.

(3) with respect to issuance of final revocation letters, this authority may not be redelegated.

2. In each region, the Regional Counsel, the Regional Director of Appeals, Chiefs and Associate Chiefs, Appeals Office, are authorized to:

(a) issue final determination or final revocation letters on appeals from proposed adverse determination and proposed revocation letters issued by key district offices under this delegation.

(b) issue letters as to the decision on appealed examination reports or statutory notices as provided in Delegation Order No. 77. [(Rev. 15), page 335, this Bulletin]

(c) This authority may not be redelegated.

3. The Assistant Commissioner (Employee Plans and Exempt Organizations), with concurrence of the Chief Counsel, is authorized to require preissuance review of final adverse determination and final revocation letters covered by section 7476(a) of the Internal Revenue Code of 1954.

4. The District Director of each Employee Plans and Exempt Organizations key district is authorized to:

(a) extend the remedial amendment period described in section 401(b) of the Internal Revenue Code of 1954 in accordance with currently applicable 401(b) procedures for individually designed plans and master and prototype plans not described in (b) below, but not in excess of eight months after the later of

(1) the due date of the employer's income tax return without extension, for the year in which the remedial amendment period begins, or

(2) the end of the plan year within which the remedial amendment period begins;

(3) however, for a plan maintained by more than one employer, the remedial amendment period may not be extended in excess of two months after the last day of the tenth month after the end of the plan year.

(b) extend the remedial amendment period for a master or prototype plan whose sponsoring organization, after September 2, 1974, and on or before December 31, 1976, filed a request for an opinion letter with respect to the plan's qualification but not in excess of eight months after the later of:

(1) June 30, 1977, or

(2) the last day of the month that is six months after the month in which (i) the opinion or notification letter is issued, (ii) the request for the letter is withdrawn, or (iii) the request is othe wise disposed of by the Service.

(c) redelegate this authority but n below Chief, EP/EO Division.

Delegation Order No. 112 (Rev. 6 [1980-2 C.B. 756] issued June 2, 1980 is hereby superseded.

JAMES OWEN,
Deputy Commissioner.

Delegation Order 113 (Rev. 7) (Effective March 21, 1982)

Authority to Issue Exempt Organization Determination Letters

Pursuant to authority vested in the Commissioner of Internal Revenue by Treasury Department Order No. 150-37, authority with respect to issuance of determination letters pertaining to the exempt status of organizations under section 501(a) and related matters is delegated as follows:

1. The District Director of each Employee Plans and Exempt Organizations key district is authorized to:

(a) Issue determination letters, except as noted in section 2, below; with respect to exemption from Federal income tax under sections 501 and 521; status under IRC 120, 170(c)(2), 507, 508, 509, 4942(j)(3), 4947, 4948, and 6033; imposition of tax under IRC 11, 511 through 514, 527(f), 641, 1381, and Chapters 41 and 42; provided the requests present questions the answers to which are clear from an application of the provisions of the statute, Treasury decisions or regulations, or by a ruling, opinion, or court decision published in the Internal Revenue Bulletin, and

(b) Issue modifications or revocations of rulings or determination letters described above in accordance with currently applicable appeal procedures, and

(c) Redelegate this authority but not below Exempt Organizations Specialist, Grade GS-12 (other than the originator) and not below Chief, Employee Plans and Exempt Organizations Division with respect to adverse modifications or revocations of such letters.

2. In each region, the Regional Counsel, the Regional Director of Appeals, Chief and Associate Chief, Appeals Office are authorized to issue final determination letters on appeals from proposed adverse determinations and proposed revocations issued by key district offices under this delegation. This authority may not be redelegated.

3. The Assistant Commissioner (Employee Plans and Exempt Organizations), with the concurrence of the Chief Counsel, is authorized to require preissuance review of specific types of final adverse determinations of issues described in IRC 7428(a)(1).

This Order supersedes Delegation Order No. 115 (Rev. 6) issued October 1, 1978 [1978-2 C.B. 482].

JAMES OWENS,
Deputy Commissioner.

Delegation Order 114 (Rev. 3) (Effective March 21, 1982)

Designation to Act as "Competent Authority" Under Tax Treaties

1. Pursuant to the authority delegated to me by Treasury Department Order No. 150-83 [1973-2 C.B. 508], there is hereby delegated to the Associate Commissioner (Operations) and to Director, Foreign Operations District as stated below, the authority to act as "competent or taxation authority" under the tax treaties of the United States.

2. The Associate Commissioner (Operations) shall have the authority to administer all those functions derived from the operating provisions of the tax treaties, other than those delegated below to the Director, Foreign Operations District. This authority may be redelegated, but not lower than the Assistant Commissioner level.

3. The Associate Commissioner (Operations) is also delegated the authority to interpret and apply such tax treaties, but in such matters shall act only with the concurrence of the Associate Chief Counsel (Technical). This authority may be redelegated, but not lower than the Assistant Commissioner level.

4. The Director, Foreign Operations District, shall have the authority to administer the following functions deriving from the operating provisions of the tax treaties: the Routine and Specific Exchange of Information Programs and the Program for Mutual Exchange of Information Programs and the Program for Mutual Assistance in Collection. This authority may not be redelegated.

5. Delegation Order No. 114 (Rev. 2), issued August 28, 1980 [1980-2 C.B. 757], is superseded.

JAMES OWENS,
Deputy Commissioner.

Delegation Order 116 (Rev. 5) (Effective March 21, 1982)

Authority to Grant Extensions of Time to File Income and Estate Tax Returns

The authority granted to the Commissioner of Internal Revenue by 26 CFR 1.608-1, 26 CFR 20.6081-1 and 26 CFR 301.7701-9 to grant extensions of time to file income and estate tax returns, is hereby delegated to District Directors, Assistant District Directors, Service Center Directors and Assistant Service Center Directors.

The Authority delegated herein for estate tax returns may be redelegated, but not below:

Advisor/Reviewer, Advisor or Reviewer in the Special Procedures function in District Offices.

Senior Tax Examiners in Service Centers.

The authority delegated herein for income tax returns may be redelegated, but not below:

Chief, Special Procedures Staff or Chief, Technical and Office Compliance Branch/Group in District Offices; and full working level Tax Examiners in Service Centers.

Delegation Order No. 116 (Rev. 4), issued July 18, 1980 [1980-2 C.B. 758], is superseded.

JAMES OWENS,
Deputy Commissioner.

Delegation Order 130 (Rev. 2) (Effective March 21, 1982)

Authority to Execute and Terminate Average Weight Agreements

Pursuant to authority vested in the Commissioner of Internal Revenue by 26 CFR 48.4071-2(b) and 26 CFR 301.7701-9, there is hereby delegated to the Assistant Commissioner (Examination), the authority to

1. Sign all agreements granting approval to determine total weight of tires and inner tubes sold on the basis of average weight schedules published by the tire industry.

2. Terminate and issue notice of termination of agreements described above.

3. This authority may not be redelegated.

4. This Order supersedes Delegation Order No. 130 (Rev. 1), issued July 2, 1978 [1978-2 C.B. 482].

JAMES OWENS,
Deputy Commissioner.

Delegation Order 136 (Rev. 4) (Effective March 21, 1982)

Authority to Sign Agreements Under Rev. Proc. 74-6 With Respect to Exercise by Trustee of Administrative and Investment Powers

1. Pursuant to authority vested in the Commissioner of Internal Revenue, the authority to sign agreements entered into under the provisions of Rev. Proc. 74-6 [1974-1 C.B. 417], is hereby delegated to the following officials:

a. Chief Counsel
b. Regional Counsels
c. Regional Directors of Appeals;
d. District Directors;
e. Chiefs, Appeals Offices and
f. Associate Chiefs, Appeals Offices.

2. The authority delegated herein may be redelegated by Regional Directors of Appeals and District Directors, and may not be further redelegated.

3. Delegation Order No. 136 (Rev. 3), issued October 1, 1978 [1978-2 C.B. 483], is superseded.

JAMES OWENS,
Deputy Commissioner.

Delegation Order 139 (Rev. 6)
(Effective March 21, 1982)

Authority to Extend the Correction Period and the Allowable Distribution Period Relating to Private Foundation and Employee Plans Matters

1. Pursuant to the provisions of 26 CFR 53.4941(e)-1(d), 26 CFR 53.4941(f)-1, 26 CFR 53.4942(a)-1(c), 26 CFR 53.4943-9(b)(2), 26 CFR 53.4943-11(b), 26 CFR 53.4944-5, 26 CFR 53.4945-1(e), IRC 4971(c)(3), IRC 4975(f)(6), and the authority vested in the Commissioner of Internal Revenue by Treasury Department Order No. 150-37, there is hereby delegated to the District Director of Internal Revenue for each of the key districts for Employee Plans and Exempt Organizations matters, Chief Counsel, Regional Counsel and the Regional Director of Appeals for each of the regions the authority to:

(a) Extend the correction period for acts of self-dealing under IRC 4941, failures to distribute income under IRC 4942, excess business holdings under IRC 4943, investments which jeopardize charitable purpose under IRC 4944, and taxable expenditures under IRC 4945;

(b) Extend the allowable distribution period for failures to distribute income under IRC 4942; and

(c) Extend the correction period for failures to meet minimum funding standards under IRC 4971, and correction of prohibited transactions under IRC 4975.

2. The authority delegated herein may be redelegated, but not lower than to Group Managers and Employee Plans and Exempt Organization Groups in Key District Offices and to Chiefs and Associate Chiefs of Appeals Offices and Appeals Team Chiefs in Regional Offices. The authority of an Appeals Team Chief is limited to those cases assigned to the Appeals Team Chief.

3. This Order supersedes Delegation Order No. 139 (Rev. 5) [1979-2 C.B. 484] issued September 6, 1979.

JAMES OWENS,
Deputy Commissioner.

Delegation Order 143 (Rev. 1)
(Effective March 21, 1982)

Authority to Enforce the Currency and Foreign Transactions Reporting Act of 1970 (Titles I and II of Public Law 91-508 [1971-1 C.B. 523])

The authority and responsibilities vested in the Commissioner of Internal Revenue by 31 CFR 103.46(a)(8) and 26 CFR 301.7701-9(c), for assuring compliance with the requirements of 31 CFR 103 which are under the jurisdiction of the Internal Revenue Service, are delegated as follows:

Assistant Commissioners (Criminal Investigation) and (Examination)
Regional Commissioners
District Directors

The authority delegated herein may be redelegated by the officials specified in this Order and may not be further redelegated.

Delegation Order No. 143 [1974-1 C.B. 411], issued December 12, 1973, is superseded.

JAMES OWENS,
Deputy Commissioner.

Delegation Order 144 (Rev. 1)
(Effective March 21, 1982)

Authority to Issue Transfer Certificates in Certain Estate Tax Cases

1. The authority granted to the Commissioner of Internal Revenue by 26 CFR 301.7701-9 and 26 CFR 20.6325-1(c) to issue transfer certificates in certain estate tax cases is hereby delegated to District Directors and the Director, Philadelphia Service Center.

2. The authority delegated herein may be redelegated only by the officials specified in this Order and may not be further redelegated.

3. This Order supersedes Delegation Order No. 144 [1974-1 C.B. 411], issued January 18, 1974.

JAMES OWENS,
Deputy Commissioner.

Delegation Order 154 (Rev. 1)
(Effective March 21, 1982)

Decision on Reports of Refunds and Credits to the Joint Committee on Internal Revenue Taxation

1. Pursuant to the authority vested in the Commissioner of Internal Revenue by Section 3777(a) of the Internal Revenue Code of 1939, Treasury Department Order No. 150-2, Sections 6405(a) and 7851(b)(3) of the Internal Revenue Code of 1954, and Treasury Department Order No. 150-36, [1954-2 C.B. 733] authority is hereby delegated to:

a. Regional Commissioners and Regional Counsels to make the decision and report to the Joint Committee on Internal Revenue Taxation as required by Section 6405(a) of the Internal Revenue Code of 1954 on cases within their regional jurisdiction.

b. Assistant Commissioner (Examination) and the Chief Counsel to take final action for the Commissioner on issues or matters formally presented by the Joint Committee on Internal Revenue Taxation relating to reports submitted under Section 6405(a) of the Internal Revenue Code of 1954.

2. The authority delegated herein may not be redelegated.

3. Delegation Order No. 154 [1976-2 C.B. 624], issued May 19, 1976, is hereby superseded.

JAMES OWENS,
Deputy Commissioner.

Delegation Order 155 (Rev. 1)
(Effective March 21, 1982)

Recommendations Concerning Settlement Offers in Refund Suits

1. Pursuant to the authority vested in the Commissioner of Internal Revenue by 26 CFR 301.7122-1 and 26 CFR 301.7701-9, the Chief Counsel i delegated the authority to sign recommendation letters to the Departmen of Justice concerning Settlement Offers for years or parties not in suit, bu related to pending refund suits for other years or parties.

2. The authority delegated herei may not be redelegated.

3. Delegation Order No. 155 [1976-2 C.B. 624], issued May 19, 1976, i superseded.

JAMES OWENS,
Deputy Commissioner.

Delegation Order 156 (Rev. 2)
(Effective March 21, 1982)

Authority to Permit Disclosure of Tax Information and to Permit Testimony or the Production of Documents

Pursuant to the authority vested in the Commissioner of Internal Revenue by Treasury Department Order No. 150-37 and in the Chief Counsel by General Counsel Order No. 4 and by Treasury Department Order No. 190 (as revised), authority to act in matters officially before their respective functions is hereby delegated as follows:

(1) The Deputy Commissioner; Associate Commissioners; Assistant Commissioners; Deputy Assistant Commissioners; Division Directors (or equivalent level position); Deputy Chief Counsel; Associates Chief Counsel; Deputy Associates Chief Counsel; Chief Counsel Division Directors; Regional Commissioners; Regional Inspectors; Regional Counsels; Deputy Regional Counsels; District Counsels; District and Service Center Directors; Director, National Computer Center; and Director, Data Center are authorized:

(a) To disclose or, in specific instances, authorize the disclosure of returns or return information to such persons as the taxpayer may designate in a written request, subject to the conditions prescribed in IRC 6103(c) and the Treasury Regulations thereunder. The authority to withhold return information upon a determination that such disclosure would seriously impair federal tax administration is also delegated. The authority delegated in this paragraph to disclose returns or return information may be redelegated to Internal Revenue Service employees and employees of the Office of Chief Counsel to the extent necessary within the exercise of their official duties. The authority delegated in this paragraph to withhold return information may be redelegated not lower than Chiefs, Special Procedures function; Group Managers (or their equivalent); Chiefs, Appeals Offices; Chiefs, Criminal Investigation Branch; and Disclosure Officers.

(b) To disclose or, in specific instances, authorize the disclosure of returns, upon the written request of an individual taxpayer, partner, corporate officer, shareholder, administrator, executor, trustee, or other person having a material interest, except as provided below in paragraph (1)(c), subject to the conditions prescribed in IRC 6103(e). The authority to disclose or, in specific instances, authorize the disclosure of return information to such persons, upon a determination that disclosure would not seriously impair federal tax administration, as prescribed in IRC 6103(e)(6), is also delegated. The authority delegated in this paragraph to disclose or authorize the disclosure of returns or return information may be redelegated to Internal Revenue Service employees and employees of the Office of Chief Counsel to the extent necessary within the exercise of their official duties. In the event a disclosure of return information would seriously impair federal tax administration, the decision to withhold such return information will be referred to officials not lower than Chiefs, Special Procedures function; Group Managers (or their equivalent); Chiefs, Appeals Offices; Chiefs, Criminal Investigation Branch; and Disclosure Officers.

(c) To disclose or, in specific instances, authorize the disclosure of returns upon the written request of a person found to have a material interest which will be affected by information contained therein, subject to the conditions prescribed in IRC 6103 (e)(1)(D)(vi), (e)(1)(E)(ii), (e)(1)(F)(ii), (e)(3)(B), and (e)(4). The authority to disclose or, in specific instances, authorize the disclosure of return information to such persons upon a determination that disclosure would not seriously impair federal tax administration, as prescribed in IRC 6103(e)(6), is also delegated. The authority delegated in this paragraph may be redelegated not lower than Chiefs, Special Proedures function; Special Procedures function Advisor Reviewers; Group Managers (or their equivalent); Chiefs, Appeals Offices; Chiefs, Criminal Investigation Branch; and Disclosure Officers.

(d) To disclose or, in specific instances, authorize the disclosure of returns or return information to attorneys of the Department of Justice in a matter involving tax administration, subject to the conditions prescribed in IRC 6103(h)(2), the Treasury Regulations thereunder, and (h)(3). The authority delegated in this paragraph may be redelegated not lower than Chiefs, Special Procedures function; Group Managers (or their equivalent); Chiefs, Appeals Offices; and to attorneys of the Office of Chief Counsel directly involved in such matters.

(e) To disclose or, in specific instances, authorize the disclosure of returns or return information to officers and employees of the Department of Treasury, as specified in IRC 6103(1)(4)(B) or, upon written request, to employees and other persons specified in IRC 6103(1)(4)(A) for use in personnel or claimant representative matters, and to make relevancy and materiality determinations as provided in section 6103(1)(4)(A), subject to the conditions prescribed in IRC 6103(1)(4). The authority delegated in this paragraph may be redelegated only to Assistant Division Directors (or equivalent level position); Assistant Regional Commissioners; Regional Director of Appeals; Assistant Regional Inspectors; Regional Chief, Personnel Branch; Assistant District and Service Center Directors; Division Chiefs; Disclosure Officers; National Office Branch Chiefs, Internal Security Division; Staff Assistants to Regional Counsels; and to attorneys of the Office of Chief Counsel and Inspectors directly involved in such matters.

(f) To disclose or, in specific instances, authorize the disclosure of returns or return information to the extent necessary in connection with contractual procurement by the Service or Office of the Chief Counsel of equipment or other property or services, subject to the conditions prescribed in IRC 6103(n) and the Treasury Regulations thereunder. The authority delegated in this paragraph may be redelegated only to Assistant Division Directors (or equivalent level position); Assistant Regional Commissioners; Regional Director of Appeals; Assistant Regional Inspectors; Assistant District and Service Center Directors; Assistants to the District and Service Center Directors; Division Chiefs; Chief Counsel Assistant Division Directors; Staff Assistants to Regional Counsels; and Disclosure Officers.

(g) To disclose or, in specific instances, authorize the disclosure of return information (other than taxpayer return information) which may constitute evidence of a threat or an irrational statement against the President or other government official to the U.S. Secret Service, subject to the conditions prescribed in IRC 6103 (i)(3). The authority delegated in this paragraph may not be redelegated.

(2) The Deputy Commissioner; Associate Commissioners; Assistant Commissioners; Deputy Assistant Commissioners; Division Directors (or equivalent level position); Regional Commissioners; Regional Inspectors; District and Service Center Directors; Director, National Computer Center; and Director, Data Center are authorized to determine whether a disclosure of returns or return information in a federal or state judicial or administrative tax proceeding would identify a confidential informant or seriously impair a civil or criminal tax investigation, subject to the conditions prescribed in IRC 6103(h)(4). The authority delegated in this paragraph may not be redelegated.

(3) The Deputy Commissioner; Associate Commissioner (Policy and Management); Assistant Commissioner (Support and Services); Deputy Assistant Commissioner (Support and Services); Regional Commissioners; Director, Disclosure and Security Division; and District and Service Center Directors; are authorized:

(a) To furnish an affirmative or negative response to a written inquiry from an attorney of the Department of Justice (including a United States Attorney) involved in a judicial tax proceeding, or any person (or his legal representative) who is a party to such proceeding, as to whether a prospective juror has or has not been the subject of any audit or other tax investigation by the Internal Revenue Service, subject to the conditions prescribed in IRC 6103(h)(5). The authority delegated in this paragraph may be redelegated only to the Assistant Director, Disclosure and Security Division (or equivalent level position); Assistant District and Service Center Directors; Assistants to the District and Service Center Directors; Division Chiefs; and Disclosure Officers.

(b) To disclose or, in specific instances, authorize the disclosure of:

(i) Accepted offers-in-compromise to members of the general public, subject to the conditions prescribed in IRC 6103(k)(1). When the liability compromised is $5,000 or over, the authority to disclose or, in specific instances. authorize the disclosure of accepted offers-in-compromise is also delegated to the Associate Commissioner (Operations); Assistant Commissioner (Collection); and Deputy Assistant Commissioner (Collection).

(ii) The amount of an outstanding lien to any person who furnishes satisfactory written evidence establishng a right in or intent to obtain a right in property subject to such lien, subject to the conditions prescribed in IRC 6103(k)(2). The authority to disclose or, in specific instances, authorize the disclosure of the amount of an outstanding lien is also delegated to the Associate Commissioner (Operations); Assistant Commissioner (Collection); and Deputy Assistant Commissioner (Collection).

(iii) Taxpayer identity information with respect to any income tax return preparer and information as to whether any penalty has been assessed against such preparer to officers and employees of any agency charged under state or local law with the regulation of such preparers, upon written request and subject to the conditions prescribed in IRC 6103(k)(5);

(iv) Returns or return information with respect to taxes imposed by IRC chapters 2, 21, and 24 to the Social Security Administration, upon written request and subject to the conditions prescribed in IRC 6103(l)(1)(A);

(v) Returns or return information with respect to taxes imposed by IRC chapter 22 to the Railroad Retirement Board, upon written request and subject to the conditions prescribed in IRC 6103(l)(1)(C).

(vi) Returns or return information with respect to taxes imposed by IRC subtitle E (relating to taxes on alcohol, tobacco and firearms) to officers and employees of the Bureau of Alcohol, Tobacco and Firearms, upon written request and pursuant to IRC 6103(o)(1).

The authority delegated in this paragraph may be redelegated only to Assistant Director, Disclosure and Security Division (or equivalent level position); Assistant District and Service Center Directors; Assistants to the District and Service Center Directors; Division Chiefs; and Disclosure Officers. In addition, the authority delegated in subparagraph (i) may also be redelegated only to Chiefs, Special Procedures function; Special Procedures function Advisor Reviewers; and Group Managers (or their equivalent). The authority delegated in subparagraph (ii) may also be redelegated only to Chiefs, Special Procedures function; Special Procedures function Advisor Reviewers; Group Managers (or their equivalent); and Revenue Officers.

(4) The Deputy Commissioner; Associate Commissioner (Policy and Management); Assistant Commissioner (Support and Services); Deputy Assistant Commissioner (Support and Services); Director, Disclosure and Security Division; and Assistant Director, Disclosure and Security Division (or equivalent level position) are authorized to disclose or, in specific instances, authorize the disclosure of returns or return information to designated state tax officials, upon written request by the head of a state tax agency, for the purpose of and to the extent necessary in the administration of state tax laws, pursuant to the provisions of IRC 6103(d) and subject to the conditions prescribed in IRC 6103(h)(4) and (p)(8). The authority to withhold return information pursuant to IRC 6103(d) and (h)(4) upon a determination that such disclosure would identify a confidential informant, or seriously impair any civil or criminal tax investigation is also delegated. The authority delegated in this paragraph does not extend to the entry into Federal/State Agreements on the Coordination of Tax Administration. The authority delegated in this paragraph may be redelegated only to the Chief, Technical and Program Branch, Disclosure and Security Division.

(5) The Deputy Commissioner; Regional Commissioners; District and Service Center Directors; and Director, National Computer Center are authorized to disclose or, in specific instances, authorize the disclosure of returns or return information pursuant to Federal/State Agreements on the Coordination of Tax Administration entered into between the head of any state tax agency and the Commissioner of Internal Revenue, pursuant to the provisions of IRC 6103(d) and subject to the conditions prescribed in IRC 6103(h)(4) and (p)(8). The authority to withhold return information pursuant to IRC 6103(d) and (h)(4) upon a determination that such disclosure would identify a confidential informant or seriously impair any civil or criminal tax investigation is also delegated. The authority delegated in this paragraph may be redelegated only to Assistant District and Service Center Directors; Assistants to the District and Service Center Directors; Division Chiefs; and Disclosure Officers, but such redelegation shall not extend to the authority to withhold return information.

(6) The Deputy Commissioner; Associate Commissioner (Policy and Management); Assistant Commissioner (Support and Services); Deputy Assistant Commissioner (Support and Services); and Director Disclosure and Security Division are authorized:

(a) To disclose or, in specific instances, authorize the disclosure of returns and return information to Congressional committees and other persons, upon written request and subject to the conditions prescribed in IRC 6103(f). The authority delegated in this paragraph may not be redelegated.

(b) To disclose or, in specific instances, authorize the disclosure of returns or taxpayer return information to officers and employees of a federal agency pursuant to an *ex parte* order by a Federal District Court judge when needed for use in the enforcement of a federal criminal statute (not involving tax administration), subject to the conditions prescribed in IRC 6103(i)(1) and the Treasury Regulations thereunder. The authority to withhold any return or taxpayer return information, pursuant to IRC 6103(i)(1) or (i)(4), upon a determination that such disclosure would identify a confidential informant or seriously impair any civil or criminal tax investigation is also delegated. The authority delegated in this paragraph may be redelegated only to the Assistant Director, Disclosure and Security Division (or equivalent level position); and Branch Chiefs and Section Chiefs, Disclosure and Security Division, but such redelegation shall not extend to the authority to withhold returns or taxpayer return information.

(c) To disclose or, in specific instances, authorize the disclosure of return information (other than taxpayer return information) to officers and employees of a federal agency upon written request by the head of such agency, or in the case of the Department of Justice, the Attorney General, the Deputy Attorney General, or an Assistant Attorney General, when needed for use in the enforcement of a federal criminal statute (not involving tax administration), subject to the conditions prescribed in IRC 6103(i)(2). The authority to withhold return information (other than taxpayer return information), pursuant to IRC 6103(i)(2) or (i)(4), upon a determination that such disclosure would identify a confidential informant or seriously impair any civil or criminal tax investigation is also delegated. The authority delegated in this paragraph may be redelegated only to the Assistant Director, Disclosure and Security Division (or equivalent level position); and Branch Chiefs and Section Chiefs, Disclosure and Security Division, but such redelegation shall not extend to the authority to withhold return information (other than taxpayer return information).

(d) To disclose or, in specific instances, authorize the disclosure in writing of return information (other than taxpayer return information), which may constitute evidence of a violation of federal criminal laws, to the extent necessary to apprise the head of the appropriate federal agency enforcing such laws, subject to the conditions prescribed in IRC 6103 (i)(3). The authority to withhold return information (other than taxpayer return information), pursuant to IRC 6103(i)(4), upon a determination that such disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation is also delegated. The authority delegated in this paragraph may be redelegated only to the Assistant Director, Disclosure and Security Division (or equivalent level position); and Branch Chiefs and Section Chiefs, Disclosure and Security Division, but such redelegation shall not extend to the authority to withhold return information (other than taxpayer return information). This authority is in addition to the authority previously delegated in paragraph (1)(g).

(e) To disclose or, in specific instances, authorize the disclosure of returns or return information to officers and employees of the General Accounting Office, upon written request by the Comptroller General of the United States and subject to the conditions prescribed in IRC 6103(i)(6). The authority delegated in this paragraph may not be redelegated.

(f) To disclose or, in specific instances, authorize the disclosure of the mailing address of a taxpayer to officers and employees of an agency when needed in connection with a federal claim against such taxpayer, upon written request and subject to the conditions prescribed in IRC 6103(m)(2). Upon approval by the Director, Disclosure and Security Division or his/her delegate of a contractual agreement for such disclosures, the authority delegated in this paragraph is also delegated to the Assistant Commissioner (Computer Services); Deputy Assistant Commissioner (Computer Services); Director, Software Division; Director, National Computer Center; and Service Center Directors. The authority delegated in this paragraph to the Deputy Commissioner; Associate Commissioner (Policy and Management); Assistant Commissioner (Support and Services); Deputy Assistant Commissioner (Support and Services); and Director, Disclosure and Security Division, may be redelegated only to the Assistant Director, Disclosure and Security Division (or equivalent level position); and Branch Chiefs and Section Chiefs, Disclosure and Security Division. The authority delegated to the Assistant Commissioner (Computer Services);

Deputy Assistant Commissioner (Computer Services); Director, Software Division; Director, National Computer Center; and Service Center Directors may not be redelegated. The authority delegated in this order does not include authority to enter into a contractual agreement, which is contained in Delegation Order No. 100, as revised [Rev. 2, 1978-2 C.B. 478].

(g) To disclose or, in specific instances, authorize the disclosure of the mailing address of taxpayers to officers and employees of the National Institute for Occupational Safety and Health, upon written request and subject to the conditions prescribed in IRC 6103(m)(3). Upon approval by the Director, Disclosure and Security Division or his/her delegate of a contractual agreement for such disclosures, the authority delegated in this paragraph is also delegated to the Assistant Commissioner (Computer Services); Deputy Assistant Commissioner (Computer Services); Director, Software Division; Director, National Computer Center; and Service Center Directors. The authority delegated in this paragraph to the Deputy Commissioner; Associate Commissioner (Policy and Management); Assistant Commissioner (Support and Services); Deputy Assistant Commissioner (Support and Services); and Director, Disclosure and Security Division, may be redelegated only to the Assistant Director, Disclosure and Security Division (or equivalent level position); and Branch Chiefs and Section Chiefs, Disclosure and Security Division. The authority delegated to the Assistant Commissioner (Computer Services); Deputy Assistant Commissioner (Computer Services); Director, Software Division; Director, National Computer Center; and Service Center Directors may not be redelegated. The authority delegated in this paragraph does not include authority to enter into a contractual agreement, which is contained in a Delegation Order No. 100, as revised.

(h) To disclose, or in specific instances, authorize the disclosure of the mailing address of any taxpayer who has defaulted on a loan made from the student loan fund established under part E of title IV of the Higher Education Act of 1965 to the Commissioner of Education, upon written request and subject to the conditions prescribed in IRC 6103(m)(4). Upon approval by the Director, Disclosure and Security Division or his/her delegate of a contractual agreement for such disclosures, the authority delegated in this paragraph is also delegated to the following officials: Assistant Commissioner (Computer Services); Deputy Assistant Commissioner (Computer Services); Director, Software Division; Director, National Computer Center; and Service Center Directors. The authority delegated in this paragraph to the Deputy Commsisioner; Associate Commissioner (Policy and Management); Assistant Commissioner (Support and Services); Deputy Assistant Commissioner (Support and Services); and Director, Disclosure and Security Division may be redelegated only to the Assistant Director, Disclosure and Security Division (or equivalent level position); and Branch Chiefs and Section Chiefs, Disclosure and Security Division. The authority delegated to the Assistant Commissioner (Computer Services); Deputy Assistant Commissioner (Computer Services); Director, Software Division; Director, National Computer Center; and Service Center Directors may not be redelegated. The authority delegated in this paragraph does not include authority to enter into a contractual agreement, which is contained in Delegation Order No. 100, as revised.

(7) The Deputy Commissioner; Associate Commissioner (Data Processing) and Assistant Commissioner (Returns and Information Processing) are authorized:

(a) To disclose or, in specific instances, authorize the disclosure of returns or return information for statistical use to officers and employees of the Department of Commerce, Bureau of Census, upon the written request of the Secretary of Commerce or to officers and employees of the Department of the Treasury, subject to the conditions prescribed in IRC 6103 (j)(1)(A) and the Treasury Regulations thereunder and (j)(3). The authority delegated in this paragraph may be redelegated only to the Director, Statistics Division.

(b) To disclose or, in specific instances, authorize the disclosure of return information for statistical use
officers and employees of the Depar
ment of Commerce, Bureau of Ec
nomic Analysis, upon the written r
quest of the Secretary of Commerc
or to officers and employees of th
Federal Trade Commission, upo
written request of the Chairman, sul
ject to the conditions prescribed i
IRC 6103(j)(1)(B) and (j)(2) and th
Treasury Regulations thereunder. Th
authority delegated in this paragrap
may be redelegated only to the D
rector, Statistics Division.

(8) The Deputy Commissioner; A
sistant to the Commissioner (Publi
Affairs); Director and Assistant D
rector, Public Affairs Division; Re
gional Commissioners; and District Di
rectors are authorized to disclose tax
payers names and the city, state an
zip code of their mailing addresses t
the press and other media for purpose
of notifying persons entitled to unde
livered tax refunds, subject to th
conditions prescribed in IRC 610
(m)(1). The authority delegated in thi
paragraph may not be redelegated.

(9) The Deputy Commissioner; As
sociate Commissioner (Policy an
Management) and Assistant Commis
sioner (Support and Services) are au
thorized: .

(a) Upon written request of th
President, to disclose, or in specific in
stances, authorize the disclosure of re
turn information (other than retur
information that is adverse to the tax
payer) of an individual who is unde
consideration for appointment to
position in the executive or judicia
branch of the Federal Government t
the authorized representative of th
Executive Office of the President or t
the Federal Bureau of Investigation o
behalf of the President, subject to th
conditions prescribed in IRC 610
(g)(2) and (g)(4). Authority is als
delegated to disclose or, in specific in
stances, authorize the disclosure of re
turn information with respect to th
categories of individuals discusse
above to the heads of federal agencie
upon written request, or the Federa
Bureau of Investigation on behalf o
and upon the written request of suc
agency heads, subject to the condition
described in IRC 6103(g)(2) an
(g)(4). Upon receipt of any request fo
return information under IR

6103(g)(2), authority to notify the individuals with respect to whom the request has been made is also delegated. The authority delegated in this paragraph may be redelegated but not lower than:

(i) Deputy Assistant Commissioner (Support and Services), in the case of requests by or on behalf of the President where the return information to be disclosed is not adverse to the taxpayer;

(ii) Assistant Director, Disclosure and Security Division (or equivalent level position), in the case of requests by or on behalf of the heads of federal agencies where the return information to be disclosed is adverse to the taxpayer;

(iii) Branch Chiefs, Disclosure and Security Division, in the case of requests by or on behalf of the heads of federal agencies where the return information to be disclosed is not adverse to the taxpayer; and

(iv) Section Chiefs, Disclosure and Security Division, concerning the notification of individuals with respect to whom a request has been made.

(b) To make the determination that an agency, body or commission or the General Accounting Office has failed to or does not meet the requirements of IRC 6103(p)(4). Subject to the administrative review applicable to State tax agencies described in IRC 6103(p)(7), authority to withhold returns and return information from any agency, body or commission or the General Accounting Office until a determination is made that the requirements of IRC 6103(p)(4) have been or will be met is also delegated. The authority delegated in this paragraph may not be redelegated.

(10) The Deputy Commissioner; Associate Commissioner (Operations); Assistant Commissioner (Employee Plans and Exempt Organizations); Deputy Assistant Commissioner (Employee Plans and Exempt Organizations); Director, Disclosure and Security Division; Regional Commissioners; District Directors of Key Districts for Employee Plans and Exempt Organizations matters; Service Center Directors; Director, National Computer Center; and Director, Data Center are authorized to disclose, or in specific instances, authorize the disclosure of:

(a) Statements, notifications, reports, or other return information described in IRC 6057(d) to officers and employees of the Social Security Administration for the administration of section 1131 of the Social Security Act, upon written request and subject to the conditions prescribed in IRC 6103(1)(l)(B). The authority delegated in this paragraph to the Assistant Commissioner and Deputy Assistant Commissioner (Employee Plans and Exempt Organizations) may be redelegated, but not lower than Branch Chief, Employee Plans Division. The authority delegated in this paragraph to the Director, Disclosure and Security Division may not be redelegated. The authority delegated in this paragraph to Regional Commissioners may be redelegated not lower than Assistant Regional Commissioner. The authority delegated in this paragraph to the District Directors of Key Districts may be redelegated, but not below Chiefs, Technical Staffs, Employee Plans and Exempt Organizations Division. The authority delegated in this paragraph to Service Center Directors may be redelegated, but not lower than Section Chiefs (or their equivalent). The authority delegated in this paragraph to the Director, National Computer Center and Director, Data Center may be redelegated, but not lower than Branch Chiefs (or their equivalent).

(b) Returns or return information, including compensation information, to officers and employees of the Department of Labor and Pension Benefit Guaranty Corporation for the administration of Titles I and IV of the Employee Retirement Income Security Act of 1974 [Pub. L. 93-406, 1974-3 C.B. 1, 172], upon written request and subject to the conditions prescribed in IRC 6103(1)(2) and the Treasury regulations thereunder. The returns or return information which may be disclosed under this paragraph include:

(i) Upon specific written request, the information specified in 26 CFR 420.6103(1)(2)-1(a), 2(a), 3(b)(1), and 3(b)(2);

(ii) Upon receipt by the Commissioner of Internal Revenue of an annual written request, the information specified in 26 CFR 420.6103(1)(2)-3(a);

(iii) Upon receipt by the Commissioner of Internal Revenue of a general written request, information specified in 26 CFR 420.6103(1)(2)-3(d).

The authority delegated in this paragraph to the Assistant Commissioner and Deputy Assistant Commissioner (Employee Plans and Exempt Organizations) may be redelegated, but not lower than Branch Chiefs of Employee Plans and Actuarial Division, except for Chief, Projects and Miscellaneous Section, Employee Plans Technical Branch. The authority delegated in this paragraph to the Director, Disclosure and Security Division may not be redelegated. The authority delegated in this paragraph to Regional Commissioners may be redelegated not lower than Assistant Regional Commissioner. The authority delegated in this paragraph to District Director of the Key Districts may be redelegated, but not lower than Chiefs, Technical Staff, Employee Plans and Exempt Organizations Division; Group Managers, Employee Plans and Exempt Organizations Division; and Employee Plans Specialist. The authority delegated in this paragraph to Service Center Directors may be redelegated, but not lower than Section Chiefs (or their equivalent). The authority delegated in this paragraph to the Director, National Computer Center and Director, Data Center may be redelegated, but not lower than Branch Chiefs (or their equivalent).

(11) The Deputy Commissioner; Associate Commissioner (Operations); Assistant Commissioner (Employee Plans and Exempt Organizations); and Deputy Assistant Commissioner (Employee Plans and Exempt Organizations) are authorized to disclose or, in specific instances, authorize the disclosure of drafts of proposed exemptions or of proposed denials of exemption requests, denial letters, and copies of information submitted by taxpayers requesting exemptions to the proper officers of the Department of Labor for consultation and coordination as required by IRC 4975(c)(2). The authority delegated in this paragraph may be redelegated not lower than Chief, Projects and Miscel-

laneous Section, Employee Plans Technical Branch.

(12) Disclosure of information to appropriate federal, state or local law enforcement officials may be made by Internal Revenue Service employees, and employees of the Office of Chief Counsel, concerning non-tax crimes which do not involve return information or the income or other financial information of an individual or entity, in accordance with the provisions of chapter (35)00 of the Disclosure of Official Information Handbook, IRM 1272. In situations where there is a question as whether the information to be disclosed is or is not return information, such as those described in IRM 1272, the Assistant Commissioner (Support and Services) and Deputy Assistant Commissioner (Support and Services) are authorized to approve or deny such requests for disclosure. The Assistant Commissioner (Support and Services) and the Deputy Assistant Commissioner (Support and Services) should act in all such matters only after coordination with the Disclosure Litigation Division, Office of Chief Counsel. The authority delegated in this paragraph may not be redelegated.

(13) The authority vested in the Commissioner of Internal Revenue by 26 CFR 301.9000-1 is delegated by this Order to the Deputy Commissioner and to Regional Commissioners; the Associate Commissioner (Policy and Management); the Assistant Commissioner (Support and Services); the Deputy Assistant Commissioner (Support and Services); District Directors; and Service Center Directors to the extent described below:

(a) Regional Commissioners, District Directors and Service Center Directors are authorized to determine whether officers and employees of the Internal Revenue Service assigned to their respective region, district or service center will be permitted to testify or produce Service records because of a request or demand for the disclosure of such records or information. For purposes of this delegation, employees of the Office of the Regional Counsel come under the authority of the Regional Commissioner. For purposes of this delegation, employees of the Office of the District Counsel come under the authority of the District Director. This paragraph does not apply to employees of the Regional Inspector. The Regional Commissioners should act in all such matters only after coordination with the Office of the Regional Counsel. District and Service Center Directors should act in all such matters only after coordination with the Office of the District Counsel. In instances where it is anticipated that the testimony or production of Service records by a District Counsel attorney will involve matters which may fall within the attorney-client privilege, the determination of whether to waive the privilege, as well as the authority to authorize the testimony or production shall lie with the Regional Commissioner who will act in these matters only after coordination with Regional Counsel. The authority delegated in this paragraph shall not extend to the disclosure of Internal Revenue Service records and information in response to a subpoena or request or other order of the Tax Court.

(See General Counsel Order No. 4, 44 F.R. 36131 (1979), which provides the authority for the disclosure of Internal Revenue Service records and information in tax court proceedings.) The authority herein may not be redelegated. See paragraphs (c), (d) and (e) below.

(b) The Associate Commissioner (Policy and Management); the Assistant Commissioner (Support and Services) and the Deputy Assistant Commissioner (Support and Services) are authorized to determine whether officers and employees of the Internal Revenue Service assigned to the National Office, including employees of the Office of Chief Counsel, and employees assigned to Regional Inspectors will be permitted to testify or produce Service records because of a request or demand for the disclosure of such record or information. The Associate Commissioner (Policy and Management); the Assistant Commissioner (Support and Services) or the Deputy Assistant Commissioner (Support and Services) should act in all such matters only after coordination with the Disclosure Litigation Division, Office of Chief Counsel. The authority delegated in this paragraph may not be redelegated. (See (c), (d), and (e) below). The authority delegated in this paragraph shall not extend to the disclosure of Internal Revenue Service records and information in response to a subpoena or request or other order of the Tax Court. (See General Counsel Order No. 4, 44 F.R. 36131 (1979)).

(c) The Associate Commissioner (Policy and Management); the Assistant Commissioner (Support and Services) and the Deputy Assistant Commissioner (Support and Services) are authorized to determine whether all officers and employees of the Internal Revenue Service and the Office of Chief Counsel, including those previously described in paragraphs (a) and (b) will be permitted to testify or produce Service records because of a request or demand for the disclosure of such records or information where testimony or production may require a disclosure of returns or return information pursuant to IRC 6103(i)(1), (2), (3), and (4). The Associate Commissioner (Policy and Management); the Assistant Commissioner (Support and Services) or the Deputy Assistant Commissioner (Support and Services) should act in all such matters only after coordination with the Disclosure Litigation Division, Office of Chief Counsel. The authority delegated in this paragraph may not be redelegated. (See (d) below).

(d) The authority delegated in paragraphs (a), (b) and (c) shall not extend to testimony or the production of Service records because of request or demand for the disclosure of such records or information:

(i) By a Congressional committee;

(ii) Involving a disclosure to the President or certain other persons pursuant to IRC 6103(g);

(iii) Involving a disclosure to the Comptroller General pursuant to IRC 6103(i)(6); or

(iv) Involving a disclosure to correct a misstatement of fact pursuant to IRC 6103(k)(3).

(e) The authority delegated to Regional Commissioners District Directors and Service Center Directors in paragraph (a) shall not extend to testimony or the production of Service records or information which may require a disclosure to a competent authority under a tax convention, whether or not such records or information were previously disclosed pursuant to such convention. The Associate Commissioner (Policy and Management), Assistant Commissioner (Support and Services) and the Deputy Assistant Commissioner (Support and Services) should act in all such matters only after authorization by the Associate Commissioner (Operations).

(14) The Deputy Commissioner; Associate Commissioner (Data Processing); Assistant Commissioner (Computer Services); Deputy Assistant Commissioner (Computer Services); Regional Commissioners; Director, Software Division; Director, National Computer Center; and Service Center Directors are authorized to disclose or, in specific instances, authorize the disclosure of individual master file information to the head of a federal, state or local child support enforcement agency or an authorized supervisory official under a contractual agreement entered into pursuant to Delegation Order 100, as revised [Rev. 2, 1978-2 C.B. 478], Rev. Proc. 78-10 [1978-1 C.B. 564], and subject to the conditions prescribed in IRC 6103(l)(6)(A)(i). Such contractual agreement should be entered into only after coordination with the Director, Disclosure and Security Division. The authority delegated in this paragraph may not be redelegated.

(15) The Deputy Commissioner; Associate Commissioner (Policy and Management); Assistant Commissioner (Support and Services); Deputy Assistant Commissioner (Support and Services); Regional Commissioners; and Service Center Directors are authorized to disclose or, in specific instances, authorize the disclosure of return information to the head of a state or local child support enforcement agency or an authorized supervisory official under a contractual agreement entered into pursuant to Delegation Order 100, as revised, Rev. Proc. 78-10, and subject to the conditions prescribed in IRC 6103 (l)(6)(A)(ii). Such contractual agreement should be entered into only after coordination with the Director, Disclosure and Security Division. The authority delegated in this paragraph may be redelegated, but no lower than Disclosure Officer.

(16) The Deputy Commissioner; Associate Commissioner (Policy and Management); Assistant Commissioner (Support and Services); Deputy Assistant Commissioner (Support and Services); Regional Commissioners; Service Center Directors; Director, National Computer Center; and Director, Data Center are authorized to disclose or, in specific instances, authorize the disclosure of information returns filed pursuant to part III of subchapter A of IRC chapter 61 to designated personnel of the Social Security Administration for the purpose of carrying out an effective return processing program in accordance with section 232 of the Social Security Act and pursuant to IRC 6103(l)(5). The authority delegated in this paragraph may not be redelegated.

(17) This Order supersedes Delegation Order No. 156 (Rev. 1) [1979-2 C.B. 485] and Chief Counsel Order No. 1031.3, issued July 30, 1979, and Delegation Order No. 156 (Rev. 1), Amend. 3, and Chief Counsel Order No. 1031.3, Amend. 1, issued January 25, 1982.

KENNETH W. GIDEON,
Chief Counsel.

ROSCOE EGGER,
Commissioner.

Delegation Order 156 (Rev. 2), Amend. 1 (Effective March 21, 1982)

Authority to Disclose Returns and Return Information to Federal Officers or Employees for Administration of Nontax Federal Criminal Laws or the Federal Claims Act of 1966.

Pursuant to the authority vested in the Commissioner of Internal Revenue by Treasury Department Order No. 150-37, authority is hereby delegated as follows:

1. The Deputy Commissioner; Associate Commissioner (Policy and Management); Assistant Commissioner (Support and Services); Deputy Assistant Commissioner (Support and Services); Director, Disclosure and Security Division; Regional Commissioners; District and Service Center Directors; and Assistant District and Service Center Directors.

a. To disclose or, in specific instances, authorize the disclosure of returns or taxpayer return information to officers and employees of a Federal agency pursuant to an *ex parte* order by a federal district court judge when needed for use in the enforcement of a federal criminal statute (not involving tax administration), subject to the conditions prescribed in IRC 6103(i)(1) and the Treasury Regulations thereunder. The authority to withhold any return or taxpayer return information, pursuant to IRC 6103(i)(1) or (i)(4), upon a determination that such disclosure would identify a confidential informant or seriously impair any civil or criminal tax investigation is also delegated. This authority may not be redelegated.

b. To disclose or, in specific instances, authorize the disclosure of return information (other than taxpayer return information) to officers and employees of a federal agency upon written request by the head of such agency, or in the case of the Department of Justice, the Attorney General, the Deputy Attorney General, or an Assistant Attorney General, when needed for use in the enforcement of a federal criminal statute (not involving tax administration) subject to the conditions prescribed in IRC 6103(i)(2). The authority to withhold return information (other than taxpayer return information), pursuant to IRC 6103(i)(2) or (i)(4), upon a determination that such disclosure would identify a confidential informant or seriously impair any civil or criminal tax investigation is also delegated. This authority may not be redelegated.

c. To disclose or, in specific instances, authorize the disclosure in writing of return information (other than taxpayer return information), which may constitute evidence of a violation of federal criminal laws, to the extent necessary to apprise the head of the appropriate federal agency enforcing such laws, subject to the conditions prescribed in IRC 6103(i)(3). The authority to withhold return information (other than taxpayer return information), pursuant to IRC 6103(i)(4), upon a determination that such disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation is also delegated. This authority may not be redelegated.

d. To disclose or, in specific instances, authorize the disclosure of the mailing address of a taxpayer to officers and employees of an agency when needed in connection with a federal claim against such taxpayer, upon written request and subject to the conditions prescribed in IRC 6103(m)(2). This authority may not be redelegated.

2. This Amendment amends paragraph (6)(b), (c), (d), and (f) of Order No. 156 (Rev. 2) [page 343, this Bulletin].

3. This Order supersedes Delegation Order No. 156 (Rev. 1), Amend 2, issued May 26, 1981 [1981-2 C.B. 542].

JAMES OWENS,
Deputy Commissioner.

Delegation Order 157 (Rev. 3) (Effective March 21, 1982)

Seizure and Forfeiture of Personal Property

(1) Pursuant to the authority granted to the Commissioner of Internal Revenue by 26 CFR 403 through 403.65,

(a) Special Agents and Internal Security Inspectors are authorized:

1. to seize personal property for forfeiture to the United States when involved, used, or intended to be used, in violation of the internal revenue laws other than Chapters 51, 52 and 53 of the Internal Revenue Code of 1954;

2. to estimate the value of seized personal property, and if valued at $2,500 or less, to cause a list to be prepared and appraisal to be obtained and to attest such list and appraisement, and to publish notice, as provided in 26 CFR 403.26; and

3. to cause notice of sale to be placed in accordance with 26 CFR 403.55 and to re-advertise the property, when necessary, in accordance with 26 CFR 403.57.

(b) District Directors and Regional Inspectors are authorized:

1. to make the determination concerning type and conditions of cost bonds as provided in 26 CFR 403.27;

2. to exercise the authority of the Commissioner concerning disposition of perishable goods provided in 26 CFR 403.30;

3. to execute the declaration of forfeiture showing that personal property has been forfeited to the United States;

4. to acquire for official use seized property by exercising the authority of the Commissioner provided in 26 CFR 403.44;

5. to determine that seized property shall be sold at public auction as provided in 26 CFR 403.55;

6. to order the destruction of any coin-operated gaming device under the provisions of 26 CFR 403.65.

(c) The Assistant Commissioner (Criminal Investigation), and the Director, Internal Security Division, are authorized:

1. to allow or deny petitions for remission or mitigation of forfeiture, accept or reject any offer in compromise of the liability to forfeiture of personal property, and to make the necessary determinations and notifications, as provided in 26 CFR 403.43, and to authorize the District Directors or Regional Inspectors to notify the petitioner or offeror of the action taken on the petition or offer.

(2) The authority delegated herein may not be redelegated.

(3) Delegation Order No. 157 (Rev. 2), issued July 2, 1978 [1978-2 C.B. 484], is superseded.

JAMES OWENS,
Deputy Commissioner.

Delegation Order 160 (Rev. 3) (Effective March 21, 1982)

Authority of Regional Director of Appeals in Termination Assessments of Income Tax and Jeopardy Assessments

1. Pursuant to the authority vested in the Commissioner of Internal Revenue under 26 CFR 301.6020-1, 26 CFR 301.6201-1, 26 CFR 301.7701-9 and Treasury Department Order No. 150-37, authority is hereby delegated to the Chief Counsel, Regional Counsels, Regional Director of Appeals, each Chief, and Associate Chief, Appeals Office, to conduct conferences and determine final disposition of requests for administrative reviews in termination assessments of income tax and jeopardy asessment cases.

2. This authority may not be redelegated.

3. Delegation Order No. 160 (Rev. 2), issued October 1, 1978 [1978-2 C.B. 484], is superseded.

JAMES OWENS,
Deputy Commissioner

Delegation Order 182 (Rev. 1) (Effective December 4, 1981)

Authority to Execute Returns

The authority granted to the Commissioner of Internal Revenue, by 26 CFR 301.6020-1(b) and 26 CFR 301.7701-9 to execute returns required by any internal revenue law or regulation made thereunder when the person required to file such return fails to do so, is delegated to:

1. Revenue Agents
2. Tax Auditors
3. Revenue Officers, GS-9 and above
4. Collection Office function managers, GS-9 and above.

To the extent that authority previously exercised consistent with this Revision may require ratification, it is hereby affirmed and ratified.

The authority delegated herein may not be redelegated.

This Order supersedes Delegation Order No. 182, [1979-2 C.B. 494] issued November 16, 1979.

JOSEPH T. DAVIS,
Acting Commissioner.

(Filed by the Office of the Federal Register on December 3, 1981, 8:45 a.m., and published in the issue of the Federal Register for December 4, 1981, 46 F.R. 59361)

Delegation Order 190 (Effective March 21, 1982)

Transfer of Technical and Appeals Functions to the Office of Chief Counsel

Pursuant to the authority granted to the Commissioner of Internal Revenue by 26 CFR 1.9100-1, 301.6020-1, 301.6201-1, 301.7701-9, the Internal Revenue Code of 1954, and Treasury Department Orders 150-32, 150-36

[1954-2 C.B. 733], 150-37, 150-83 [1973-2 C.B. 508], 177-19, and paragraphs 8 and 9 of Treasury Department Order 150-95, paragraph 6 of Treasury Department Order 150-95 is effective, as of the effective date of this Order. The Chief Counsel, or his/her delegate is hereby authorized to perform (1) all functions performed by the Corporation Tax, and Individual Tax Divisions, and (2) the National Office and field functions of Appeals, which were performed prior to the effective date of this Order except as provided below. The functions delegated include, but are not limited to:

1. Exclusive jurisdiction, including engineering and valuation activities, to issue letter rulings (with respect to prospective transactions or completed transactions if the request was made before any affected returns have been filed) and to issue technical advice memoranda; to propose revenue rulings and revenue procedures; to grant a reasonable extension of time fixed by regulations for making an election or application for relief in respect of tax under Subtitle A of the Code, subject to the requirements of 26 CFR 1.9100-1; to prescribe the extent, if any, to which any ruling issued by or pursuant to authorization from the Chief Counsel relating to the internal revenue laws shall be applied without retroactive effect; and interpret the tax treaties for the official from time to time designated as the "competent or taxation authority" under tax treaties of the United States;

   (a) The authority delegated to the Assistant Commissioner (Technical) in Delegation Order No. 165 (Rev. 3) [1981-1 C.B. 610] to respond to appeals filed pursuant to the Freedom of Information Act, 5 U.S.C. 552 (FOIA), is not transferred to the Chief Counsel.

2. The authority to enter into and approve a written agreement with any person relating to the internal revenue tax liability of such person (or with the person or estate for whom he/she acts) in cases under his/her jurisdiction, but not to set aside any closing agreement;

3. The authority to represent the Commissioner in determining liability, qualification, exempt status, or foundation qualification for the following types of cases not docketed in the United States Tax Court where the taxpayer does not agree with the determination made by the District Director, Service Center Director, or by the Director of International Operations and such taxpayer requests reconsideration by the Regional Director of Appeals:

   (a) Except as qualified below, cases and/or work units determining liability for excise, employment, income, estate (including extensions for paying estate tax under Code Section 6161(a)(2) and determinations whether elections made by estates meet the conditions specified in Code Sections 6166 and 6166A) and cases and/or work units determining liability for gift taxes including additions to tax, additional amounts and assessable penalties under Chapter 68 of Subtitle F of the Internal Revenue Code of 1954 or corresponding provisions of the Internal Revenue Code of 1939;

   (b) Responsibility for the administrative system of tax appeals for cases involving offers-in-compromise, penalty appeals, recommendations concerning settlement offers in refund suits, Code section 534(b) letters, refund claims including Joint Committee cases, and overassessments in which a taxpayer appeals the decision of a District Director, a Service Center director or the Director of International Operations.

   (c) Initial or continuing qualification under Subchapter D of Chapter 1 of the Internal Revenue Code 1954 and initial or continuing exempt status and foundation classification *except* when a National Office ruling on the case with respect to exempt status or foundation classification, or National Office technical advice, with respect to qualification, exempt status or foundation classification, has been issued. In certain instances such as cases arising from the Examination function or cases in which a National Office technical advice covers only a portion of the qualification issue of an employee plan, Appeals officials will have jurisdiction over the *proposed action* where a National Office ruling on the case with respect to exempt status or foundation classification or a National Office technical advice, with respect to qualifications, exempt status or foundation classification has been issued. If the Appeals proposed disposition is contrary to the National Office ruling on the case with respect to exempt status or foundation classification or the National Office technical advice with respect to qualification, exempt status or foundation classification, the Assistant Commissioner (Employee Plans and Exempt Organizations) or the delegate of the Associate Chief Counsel (Technical) in Code section 521 cases, will make the final decision.

   (d) The excise and employment taxes subject to the provisions of this Order include any federal excise or employment tax under the Internal Revenue Code of 1954, except any tax imposed by the following provisions or corresponding provisions of the Internal Revenue Code of 1939:

      (i) Subtitle E; or

      (ii) Subchapter D, Chapter 78 of Subtitle F, insofar as it relates to taxes imposed under Subtitle E.

4. To utilize Appeals personnel to settle in whole or in part cases docketed in the Tax Court for such periods of exclusive jurisdiction as he/she shall deem appropriate. For purposes of any statutory provisions which may require that a taxpayer exhaust the administrative remedies available within the Internal Revenue Service, all Appeals functions pertaining thereto are considered to be within the Service notwithstanding any other provision in this Order.

5. To supervise and evaluate the work of all officers and employees of the functions transferred including but not limited to the (i) Appeals functions, and (ii) the Income Tax Division and Corporate Tax Division (formerly

under the supervision of the Assistant Commissioner (Technical) and (iii) to take necessary action in all personnel matters pertaining thereto, including those for the appointment, classification, promotion, demotion, reassignment, transfer or separation of such officers and employees, with the exception of promotions, demotions, or separations to or from the Senior Executive Service [SES].

6. In exercising the authority granted in paragraph 5 above with respect to the Appeals function, the Chief Counsel shall utilize the Internal Revenue Service Executive Resources Board [E.R.B.] for selection of SES and Resource Board covered positions. With regard to the selection of non-E.R.B. Appeals personnel a majority of each selection panel will be Appeals personnel. Notwithstanding any other grant of authority in this Order, the Commissioner retains the final authority with regard to all personnel, policies, practices, and matters affecting working conditions as well as all conditions of employment. The appointment of any person as an attorney in the Appeals function or transfer of any person in the Appeals function from non-attorney status to attorney status shall require the Commissioner's approval or the approval of the Deputy Commissioner.

7. The following Commissioner's Delegation Orders are continued in effect, together with any other Delegation Orders where authority has been delegated to Appeals and Technical personnel to the extent transferred by this Order and T.D.O. 150-95. These orders are subject to the provision that the Chief Counsel or his/her delegate may revoke any portion of such orders which pertain to officers and personnel under his/her supervision and redelegate such authority to other officers and employees under his/her supervision provided such authority may be revoked or redelegated: 8 (Rev. 7) [1979-1 C.B. 473], 11 (Rev. 12) [1980-2 C.B. 754], 25 (Rev. 11), 35 (Rev. 11) [1980-1 C.B. 571], 42 (Rev. 15) [page 334, this Bulletin], 77 (Rev. 14) [1980-1 C.B. 573], 93 (Rev. 7) [1980-1 C.B. 573], 107 (Rev. 5) [1979-1 C.B. 476], 109 (Rev. 5) [1979-1 C.B. 476], 112 (Rev. 6) [1980-2 C.B. 756], 113 (Rev. 6) [1978-2 C.B. 482], 136 (Rev. 3) [1978-2 C.B. 483], 139 (Rev. 5) [1979-2 C.B. 484], 160 (Rev. 2) [1978-2 C.B. 484], 171 [1978-2 C.B. 485] and 179 [1979-2 C.B. 493].

8. The following Commissioner's Delegation orders are supplemented and amended consistent with the provisions of this Order:

(a) All of Orders Nos. 60 (Rev. 5) [1979-2 C.B. 482] and 66 (Rev. 10) [1980-1 C.B. 571] and

(b) Paragraphs 1, 4 and 5 of Order No. 97 (Rev. 18) [1980-1 C.B. 574].

9. Commissioner's Delegation Orders Nos. 96 (Rev. 5) [1981-2 C.B. 541], 114 (Rev. 2) [1980-2 C.B. 757] and 183 [1980-2 C.B. 759] are amended by substituting the words "Associate Chief Counsel (Technical)" for the words "Assistant Commissioner (Technical)" wherever they appear in those orders.

10. With regard to paragraph 3(b) above: Delegation Orders No. 14 (Rev. 1) [1978-2 C.B. 467], 154 [1976-2 C.B. 624] and 155 [1976-2 C.B. 624] are appropriately conformed.

11. Delegation Order Nos. 39 (Rev. 11) and 89 (Rev. 4) are supplemented by adding the words "Chief Counsel" and "Regional Counsel."

12. The authority delegated in Delegation Order No. 9 (Rev. 6) regarding use of Government automobiles is also delegated to the Chief Counsel and to his/her delegate and to the Regional Counsel.

13. Delegation Order No. 153 [1975-2 C.B. 542], Nationwide Authority to Make Determinations on Certain Oil Related Issues, is not affected by this Order.

14. As of the effective date of this Order, all personnel performing any previously delegated function prior to the effective date of this Order are hereby authorized to continue to perform such function to the extent not inconsistent with this Order. However, the Chief Counsel is authorized to take appropriate action to further the orderly and expeditious transfers and exercise of functions described in this Order.

ROSCOE EGGER,
Commissioner.

Delegation Order 191
(Effective February 25, 1982)

Authority to Levy on Property in Hands of Third Parties

The authority vested in the Commissioner of Internal Revenue and District Directors by 26 CFR 301.7701-9 and 301.6331-1, to levy on wages, salaries, other income and bank deposits in the possession of third parties is also delegated to the Chief, Collection Branch in the Compliance Division, Service Center.

This authority may be redelegated only to Collection Branch personnel in the GS-1169 series and to Collection GS-592 supervisory personnel.

ROSCOE L. EGGER, JR.,
Commissioner.

(Filed by the Office of the Federal Register on February 25, 1982, 8:45 a.m., and published in the issue of the Federal Register for February 26, 1982, 47 F.R. 8447)

Executive Order 12359

Public International Organizations Entitled to Enjoy Privileges, Exemptions, and Immunities

By the authority vested in me as President of the United States of America by Section 1 of the International Organizations Immunities Act (59 Stat. 669, 22 U.S.C 288) [Pub.L. 291, 1946-1 C.B. 323], and having found that the United States participates in the following organizations, it is hereby ordered as follows:

Section 1. The Multinational Force and Observers, in which the United States participates pursuant to Section 138 of Public Law 97-51 and Public Law 97-132, is hereby designated as a public international organization entitled to enjoy the privileges, exemptions, and immunities conferred by the International Organizations Immunities Act.

Sec. 2. The International Food Policy Research Institute, in which the United States participates pursuant to Section 301(h) of the Foreign Assistance Act of 1961, as amended (22 U.S.C. 2221(h)), is hereby designated as a public international organization entitled to enjoy the privileges, exemptions, and immunities conferred by the

International Organizations Immunities Act; except those provided by Section 2(a), Section 2(b), Section 2(c), that portion of the last clause of Section 2(d) relating to official communications, and Section 7(b) of that Act (22 U.S.C 288a(a), (b), (c), the last clause of (d) and 288d(b)).

RONALD REAGAN,
THE WHITE HOUSE,
April 22, 1982.

(Filed by the Office of the Federal Register on April 23, 1982, 10:54 a.m., and published in the issue of the Federal Register for April 26, 1982, 47 F.R. 17791)

Issuance of Determination Letters and Ruling Letters on Plans Qualified Cash or Deferred Arrangements

Notice 82-1

Taxpayers may rely on the proposed regulations relating to cash and deferred plans under sections 401(k) and 402(a)(8) of the Internal Revenue Code.

Proposed regulations under sections 401(k) and 402(a)(8) of the Code were published in the issue of the Federal Register for November 10, 1981, 46 F.R. 55544. (EE-169-78, 1981-2 C.B. 753.)

Pending adoption of the final regulations under sections 401(k) and 402(a)(8) of the Code, the Service will apply the proposed regulations issued under those sections as guidelines in issuing determination letters and rulings involving cash or deferred provisions in a profit-sharing or stock bonus plan. Taxpayers may rely on those proposed regulations in drafting plans to meet the requirements of section 401(k) and in requesting determination letters and rulings.

This Notice applies until final regulations are issued under sections 401(k) and 402(a)(8) of the Code, unless it is withdrawn or modified by the Service before that time.

Tables of Covered Compensation Based on Taxable Wage Base under the Social Security Act

Notice 82-2

Rev. Rul. 71-446, 1971-2 C.B. 187, provides guidelines for determining whether the benefits or contributions of a plan integrate properly with benefits or contributions under social security. Rev. Rul. 78-92, 1978-1 C.B. 118 clarified the application of the rules after the changes made by the Social Security Amendments of 1977, Pub. L. 95-216, 1978-1 C.B. 462.

Section 3.02 of Rev. Rul. 71-446 and section 3 of Rev. Rul. 78-92 provide tables of covered compensation which are based on the taxable wage base under the Social Security Act.

For purposes of determining covered compensation or the offset in any integrated plan, the increase to $32,400 in the taxable wage base for 1982 will be considered to be enacted as of January 1, 1982.

The covered compensation or the offset for any participant who separates from service in 1982 shall be determined without regard to any increase in the taxable wage base above the $32,400 taxable wage base for 1982.

Below are Tables I and II which replace Tables I and II of section 3 of Rev. Rul. 78-92, for 1982.

COVERED COMPENSATION
1982

Calendar Year of 65th Birthday	*Table I*	*Table II*
1982	$10,800	$11,004
1983	12,000	11,892
1984	12,600	12,708
1985	13,200	13,464
1986	14,400	14,172
1987	15,000	14,820
1988	15,600	15,420
1989	16,200	15,996
1990	16,800	16,524
1991	16,800	17,016
1992	17,400	17,484
1993	18,000	17,916
1994	18,600	18,336
1995	19,200	19,128
1996	19,800	19,908
1997	21,000	20,700
1998	21,600	21,492
1999	22,200	22,272
2000	22,800	23,064
2001	24,000	23,856
2002	24,600	24,588
2003	25,200	25,332
2004	25,800	26,028
2005	27,000	26,736
2006	27,600	27,432
2007	28,200	28,140
2008	28,800	28,812
2009	29,400	29,424
2010	30,000	29,976
2011	30,600	30,492
2012	31,200	30,984
2013	31,200	31,440
2014	31,800	31,860
2015	32,400	32,136
2016	32,400	32,316
2017 and later	32,400	32,400

Plan Amendments to Comply With the Economic Recovery Tax Act of 1981 (P.L. 97-34)

Notice 82-3

This Notice provides guidance with respect to the effect of certain provisions of the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256] (ERTA) on qualified retirement plans (including Subchapter S plans, and HR-10 (Keogh) plans), Individual Retirement Arrangements (IRAs) and Simplified Employee Pensions (SEPs). This Notice also provides guidance with respect to certain changes that may be made to master, prototype, field prototype, pattern and individually designed plans, IRAs, and SEPs and their effect on a prior favorable determination, notification or opinion letter.

GENERAL GUIDELINES

The guidance provided by this Notice may be relied on by individuals, employers and plan sponsors until applicable regulations under sections of the Internal Revenue Code amended by ERTA are published. To the extent that those regulations are inconsistent with the guidelines in this Notice, the regulations will be applied without retroactive effect.

ERTA does not require that any qualified retirement plan, IRA, or SEP be amended to continue its favorable tax treatment under the Internal Revenue Code. However, amendments must be made for an IRA, SEP, or retirement plan to take advantage of certain provisions of ERTA. The amendments described in Sections I, II, and III, below, may be made without adversely affecting the qualified status of the plan, IRA or SEP or the right of the individual, employer or sponsor to rely on a prior letter issued with respect to the plan, IRA or SEP. Any amendment that may be adopted without the loss of reliance should be made consistently throughout the document and should not be submitted to the Internal Revenue Service for a determination letter, opinion letter, notification letter or ruling. Except as otherwise indicated, all ERTA amendments described below are effective for plan years (for qualified retirement plans where the employer has a calendar taxable year), calendar years (for SEPs), and individuals' taxable years (for IRAs) beginning after December 31, 1981.

All citations in this Notice are to the Internal Revenue Code of 1954, as amended by ERTA.

I. *Individual Retirement Arrangements (IRAs)*

A. Deductible Limits

Explanation

ERTA increased the annual deductible contribution limit to the lesser of $2,000 or 100 percent of compensation. The previous deductible limitation was the lesser of $1,500 or 15 percent of compensation. (Section 219(b)(1).)

Amendment

Amendments made to prototype IRAs, employer sponsored IRAs or the IRS models (Form 5305, Individual Retirement Trust Account, and Form 5305-A, Individual Retirement Custodial Account) may replace the $1,500 or 15 percent of compensation limit with the $2,000 or 100 percent of compensation limit.

b. Spousal IRAs

Explanation

ERTA increased the deductible contribution limit for taxpayers with spouses who have no compensation from $1,750 to $2,250. In addition, ERTA replaced the requirement that such contributions be equally divided between the IRAs of the working and non-working spouses with a provision that deductible contributions on behalf of either spouse may not exceed $2,000.

Amendment

Amendments to IRAs described above may replace the $1,750 limit with the $2,250 limit and delete any language which requires equal contributions on behalf of each spouse. However, the amendment must also provide that an amount greater than $2,000 may not be credited to either spouse's account on account of a single taxable year except in the case of a rollover or SEP contribution.

II. *SEPs and Subchapter S or Keogh Defined Contribution Plans*

A. Contribution Limits

Explanation

ERTA increased from $7,500 to $15,000 the maximum deductible contribution that may be made for individuals under SEPs or under defined contribution plans that provide for contributions on behalf of self-employed individuals or shareholder employees of Subchapter S Corporations. The 15 percent of compensation (including earned income) limitation on contributions was not changed. (Sections 219(b)(2), 404(e) and 1379(b)(1).)

Amendment

Keogh plans, Subchapter S plans and SEPs, including the IRS model (Form 5305-SEP, Simplified Employee Pension—Individual Retirement Accounts Contribution Agreement), may be amended to change the dollar contribution limit from $7,500 to $15,000 wherever it appears. The percentage of compensation or earned income limitation may be changed, but may not exceed 15 percent. The latter amendment may be made without regard to whether the dollar limitation is changed.

B. Compensation Levels

Explanation

ERTA increased to $200,000 the maximum compensation that may be taken into account for determining contributions under SEPs, and under defined contribution plans that provide for contributions on behalf of self-employed individuals or shareholder employees of Subchapter S Corporations. However, if compensation in excess of $100,000 is taken into account, contributions on behalf of each employee (other than a self-employed individual or shareholder employee) must be at a rate (expressed as a percentage of compensation) not less than 7.5 percent. (Sections 401(a)(17) and 408(k)(3)(C).)

Amendment

SEPs and defined contribution Keogh and Subchapter S plans that currently provide that the maximum amount of compensation which may be taken into account is $100,000, may be amended by changing the $100,000 level to an amount not to exceed $200,000. However, if that change is made in the plan or SEP, language must also be added to provide the following:

1) For Plans Where the Contribution Is a Specified Percentage of Compensation

The rate of employer contributions for any plan participant who is a common law employee shall be at least 7.5 percent of that participant's compensation (reduced by 7 percent of that participant's compensation not in excess of the social security taxable wage base).

2) For Plans Where the Contribution Is Not a Specified Percentage of Compensation

If any amounts are allocated based on compensation in excess of $100,000, the amounts allocated to any participant who is a common law employee shall be at least 7.5 percent of that participant's compensation (reduced by 7 percent of that participant's compensation not in excess of the social security taxable wage base).

3) For SEPs

If any amounts are allocated based on compensation in excess of $100,000, the amounts allocated to each employee for whom a contribution is required shall be at least 7.5 percent of that employee's compensation (reduced by any taxes imposed under section 3111(a) or 1401(a), or which would be imposed but for section 1402(c)(4) or (5) of the Code).

If a plan or SEP described in (1), (2), or (3) above is not otherwise integrated with social security benefits, the parenthetical language is not to be included in the amendment. If an integrated plan described in (1) or (2) covers an owner-employee, the words "7 percent of that employee's compensation not in excess of the social security taxable wage base" must be replaced with "any taxes imposed on the employer under section 3111(a) of the Code." Furthermore, a percentage smaller than 7 percent may be used where that percentage appears in the parenthetical language and an amount lower than the taxable wage base may also be used.

C. Time for Making Amendments

Because these amendments affect deductions for contributions to Keogh and Subchapter S Plans, they must be adopted no later than two and one-half months after the close of the plan year to be effective for such plan year. Amendments to SEPs must be adopted by April 15th following the calendar year to be effective for that calendar year. If contribution limits or compensation levels are increased for a SEP, the changes must be included in any disclosure statement required to be provided to plan participants.

D. Five-Year Ban on Contributions To A Keogh Plan for Withdrawals By An Owner-Employee Made Before Age 59½

Explanation

ERTA provides that withdrawals from terminated Keogh plans by an owner-employee who has not attained age 59½ no longer result in a five-year ban on contributions to any plan on behalf of that owner-employee. This provision is effective for distributions made after 1980 in taxable years beginning after December 31, 1980. (Section 401(d)(5).)

Amendment

Language in Keogh plans which precludes distributions from a terminated plan to an owner-employee before age 59½ may be deleted. Also, language precluding contributions on behalf of an owner-employee who has received a distribution before age 59½ may be amended to provide for an exception for distributions made in the event the plan is terminated.

E. Excess Contributions

Explanation

ERTA eliminates the premature distribution penalty for withdrawals from a Keogh plan to correct an excess contribution, if the withdrawal occurs in the year of the excess contribution or prior to the due date of the return for that year (including extensions thereof). (Section 72(m)(9).)

Amendment

Language in a Keogh plan precluding the withdrawal of contributions and earnings thereon by an owner-employee who is not age 59½ or disabled may be amended to exclude from this prohibition any withdrawal of an excess contribution and earnings thereon made before the due date (including extensions) of the income tax return for the year the excess contribution was made.

III. *Taxability of Distributions to Employees*

Explanation

ERTA eliminates the provision for taxing participants and their beneficiaries on amounts "made available" under qualified plans. Thus, amounts that are made available, but not yet distributed from the plan, generally will not be taxable to the participant until actually distributed. Many plans contain election or penalty provisions that were designed solely to prevent amounts from being made available to plan participants before they are actually distributed. These plan provisions are no longer required in order to avoid taxation of participants on amounts that have not been distributed from the plan. (Section 402(a).)

Amendment

Language providing elections or penalty provisions designed solely to prevent amounts from being made available to participants prior to distribution may be removed from a plan without causing any amounts to be taxed to the participants. However, certain restrictions on distributions are required for a particular retirement plan to be qualified. (See, for example, sections 1.401-1(b)(1)(i) and (ii) and 1.401-4(c) of the Income Tax Regulations and section 401(d)(4)(B) of the Code.) Deletion of the restrictions required for the plan to be qualified will result in the loss of favorable tax treatment. Furthermore, if the removal of restrictions on distributions leads to withdrawals which cause the plan to operate primarily for the benefit of the employees who are officers, shareholders, or highly compensated, the plan will lose its qualified status.

IV. *Deductible Voluntary Employee Contributions*

ERTA provides that employees may make deductible voluntary employee contributions to qualified plans or governmental plans maintained by their employers. These deductible voluntary employee contributions for any taxable year are limited to the lesser of $2,000 or 100 percent of the employee's compensation. (Section 219(a) and (e).)

Employers and plan sponsors who do not desire their plans to accept deductible voluntary contributions are not required to amend their plans to preclude them from accepting such contributions regardless of whether the plans currently accept nondeductible voluntary employee contributions. However, those employers and sponsors may if they so desire amend such plans to specifically preclude acceptance of deductible voluntary employee contributions without loss of reliance on any prior favorable letter issued by the Service with respect to the plan.

If a plan currently provides for voluntary employee contributions, it need not be amended in order to accept deductible voluntary employee contributions. However, even though no amendment is required, an affirmative action by the plan administrator which manifests an intent to accept such contributions must be taken. For example, the employer could inform participants that the plan will accept such contributions, and describe the method that will be used to designate contributions as deductible voluntary contributions. Also, separate accounting for the deductible and nondeductible contributions may be required to prevent any reporting penalties to plan administrators or adverse tax consequences to contributing employees.

If a plan does not currently provide for voluntary employee contributions, it must be amended in order to accept deductible voluntary employee contributions. Any such amendment must be submitted to the Service for a new determination, notification, or opinion letter, whichever is appropriate, in order for the employer or sponsor to be able to continue to rely on a prior favorable letter issued with respect to the plan.

A qualified plan must continue to limit nondeductible voluntary employee contributions to 10 percent of compensation. However, deductible voluntary employee contributions are not subject to this limitation or to the limitation on annual additions to defined contribution plans under section

415(c). A plan that currently permits voluntary contributions may be amended to permit deductible voluntary contributions in an amount not greater than the lesser of $2,000 or 100 percent of compensation, in addition to nondeductible voluntary contributions of 10 percent of compensation. However, such an amendment must be submitted to the Service for a new determination, notification or opinion letter, whichever is appropriate, in order for the employer or sponsor to rely on a prior favorable letter issued with respect to the plan.

Qualified Joint and Survivor Annuities

Notice 82-4

This notice provides guidance relating to section 401(a)(11) of the Internal Revenue Code. Section 401(a)(11) sets forth the qualified joint and survivor annuity requirements which certain retirement plans must meet in order to qualify under section 401(a).

On July 29, 1981, the Court of Appeals for the Third Circuit affirmed the decision of the Tax Court in *BBS Associates, Inc. v. Commissioner of Internal Revenue*, 74 T.C. 1118 (1980), *aff'd* No. 80-2851 (3d Cir. July 29, 1981). The Court's decision invalidated certain parts of the regulations under section 401(a)(11). The invalidated regulations stated that if a life annuity is offered under a plan as a benefit option the normal form of benefit distribution must be a qualified joint and survivor annuity.

The Internal Revenue Service will not file a petition for a writ of certiorari in this case. Also, the Service will no longer follow the invalidated parts of the regulation but will amend the regulations under section 401 (a)(11).

In order to facilitate the adoption and amendment of retirement plans and the submission of those plans to the Service for advance determination letters during the interim, this Notice provides a summary of the changes expected to be made in the amended regulations. This summary may be relied upon prior to the adoption of amended regulations.

The changes expected to be made in the amended regulations are as follows.

(1) A plan provision to pay benefits in a form that is not a life annuity (as defined in section 1.401(a)-11(b)(1) of the regulations) unless the participant elects otherwise will not cause the plan to fail to satisfy section 401(a)(11).

(2) If a plan provides for any form of benefit payment as a life annuity (other than a qualified joint and survivor annuity), no such life annuity benefit may be paid unless the election not to take a qualified joint and survivor annuity described in section 1.401(a)-11(c)(1) has been made. This, of course, applies only with respect to participants described in sections 1.401(a)-11(a)(1)(i)(A), (B), (C), and (D).

(3) The early survivor annuity requirements in section 1.401(a)-11(a) and the provisions of paragraphs (b), (c), (d), and (e) of section 1.401(a)-11 will not be changed.

Inflation Adjustment for Computation of Windfall Profit Tax

Notice 82-5

Section 4989(b) of the Internal Revenue Code requires the determination of an inflation adjustment factor for use in computing the windfall profit tax.

The Service has determined that, for oil removed during the April - June quarter of 1982, the inflation adjustments are as follows:

Tier 1 or Tier 2 oil	0.2410
Tier 3 oil	0.3045

Worksheets for computation of the windfall profit tax are included in the Instructions for Form 6047, Windfall Profit Tax, and an explanation of the inflation adjustment may be found in the Specific Instructions for Line 4 of the worksheets.

Nonconventional Source Fuel Credit; Publication of Inflation Adjustment Factor and Reference Prices for Calendar Year 1981

Notice 82-6

AGENCY: Internal Revenue Service, Treasury.

ACTION: Publication of inflation adjustment factor and reference prices for calendar year 1981 as required by section 44D(d)(2)(A) of the Internal Revenue Code (USC 44D(d)(2)(A)).

SUMMARY: The inflation adjustment factor and reference prices are used in determining the availability of the tax credit for production of fuel from nonconventional sources under section 44D of the Internal Revenue Code.

DATE: The 1981 inflation adjustment factor and reference prices apply to qualified fuels produced and sold during calendar year 1981.

FOR FURTHER INFORMATION CONTACT:

For the inflation factor—Paul Grayson, PM:PFR:R, Room 403, Internal Revenue Service, 1201 E. Street, N.W., Washington, D.C. 20224, Telephone number (202) 376-0143 (not a toll-free number).

For the reference prices—Noel J. Sheehan, CC:C:E, Room 5240, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C., 20224, Telephone Number (202) 566-4463 (not a toll-free number).

The inflation adjustment factor for calendar year 1981 is 1.1900.

The reference price for qualified fuels other than gas from Devonian shale is $32.19 per barrel for the 1981 calendar year.

For gas from Devonian shale, the reference price is $5.65 per MCF for the 1981 calendar year.

(Filed by the Office of the Federal Register on March 31, 1982, 8:45 a.m., and published in the issue of the Federal Register for April 1, 1982, 47 F.R. 13949)

Plan Amendments to Comply with Section 414(m) of the Internal Revenue Code; Master and Prototype, Pattern, Basic and Field Prototype Plans.

Notice 82-7

This notice provides the time period within which master or prototype plans (including Simplified Employee Pensions (SEPs)) pattern plans, basic plans, and field prototype plans, must be amended to comply with section

414(m) of the Internal Revenue Code.

Section 414(m) was added by Section 201 of Pub. L. 96-605, 1980-2 C.B. 702, at 705. Section 414(m) requires that all the members of an affiliated service group be treated as one employer for purposes of determining if certain requirements of section 401(a), and the requirements of sections 408(k), 410, 411, and 415 have been met. For plans not in existence on November 30, 1980, section 414(m) is effective for plan years ending after November 30, 1980. For plans in existence on November 30, 1980, section 414(m) is effective for plan years beginning after November 30, 1980.

Rev. Proc. 81-12, 1981-1 C.B. 652, sets forth procedures to be followed in obtaining a determination letter with respect to the impact of section 414(m) of the Code on a particular employee benefit plan. Rev. Proc. 81-12 also provides that the National Office of the Internal Revenue Service will issue rulings as to whether a taxpayer is a member of an affiliated service group.

In order to ease the administrative burden on sponsors of master, prototype, pattern, basic, and field prototype plans, and employers adopting such plans, pursuant to the authority contained in section 7805(b) of the Code, such sponsors and adopting employers will be considered as timely amending their plans to comply with section 414(m) of the Code if they meet the following guidelines.

If a sponsor submits to the Service by December 31, 1982, amendments that are designated as conforming a master, prototype, pattern, basic or field prototype plan to the requirements of section 414(m) of the Code, then an adoption employer will have until the later of the end of the sixth calendar month after the Service issues an opinion, notification, or determination letter with respect to such plan, or the last day of the first plan year beginning after December 31, 1983, to adopt such amendments. If a sponsor does not submit the amendments by December 31, 1982, then the adopting employer must comply with the time period stated by Rev. Proc. 81-12 (as modified by Notice 82-8, this page, this Bulletin). Regardless of whether the sponsor submits the amendments to the Service by December 31, 1982, in no event will the time period be less than that provided in Rev. Proc. 81-12 and Notice 82-8; however, the adopting employer must make such amendments effective from the first day of the first plan year for which section 414(m) applies to that plan.

In accordance with Rev. Proc. 81-12, an employer may obtain a ruling from the National Office of the Service on whether that employer is a member of an affiliated service group. Additionally, if an adopting employer of a master or prototype plan (excluding a Simplified Employee Pension (SEP)), a pattern plan, a basic plan, or a field prototype plan is, or has reason to believe that the employer may be, a member of an affiliated service group, the employer can request from the appropriate key district office a determination whether the plan meets applicable requirements of section 414(m).

An adopting employer who wants a determination whether the plan meets the applicable requirements of section 414(m) must attach the information required by section 6 of Rev. Proc. 81-12 to Form 5307 (Short Form Application for Determination for Employee Benefit Plan) and submit the information, completed Form 5307, completed Form 5302 (Employee Census), and any other materials to the appropriate key district office. In addition, if the employer who wants a determination on section 414(m) has adopted a master or prototype plan that covers self-employed individuals, the employer must write "414(m)" in bold face at the top of the Form 5307, check block 7(a)(iii) instead of 7(a)(i), and write "H.R.10" within block 7(a). The employer must also fill in all remaining blocks of Form 5307 in accordance with the instructions to the form.

The failure of the adopting employer to follow the above procedures will result in the employer being unable to rely on any favorable determination opinion, or notification letter concerning the effect of section 414(m) of the Code on the qualified status of the plan.

A sponsor of a master or prototype Simplified Employee Pension (SEP) must provide in the SEP that all members of an affiliated service group will be considered a single employer for purposes of determining eligibility to participate in the plan and that any allocation under the plan will be based upon all the compensation (up to the extent permitted by law) received from all members of the affiliated service group during the calendar year for which the allocation is made. This will make sure that the adopting employers can rely upon the form of the SEP with regard to the requirements of section 414(m) of the Code. The omission of the above requirements in the SEP will result in the adopting employers being unable to rely on the opinion letter concerning the effect of section 414(m) of the Code on the SEP.

Guidance for meeting the requirements of section 414(m) of the Code is provided in Rev. Rul. 81-105, 1981-1 C.B. 256.

Plan Amendments to Comply with Section 414(m) of the Internal Revenue Code; Individually Designed Plans

Notice 82-8

This notice provides an extension of the time period within which individually designed retirement plans must be amended to comply with section 414(m) of the Internal Revenue Code.

Section 414(m) was added by Section 201 of Pub. L. 96-605, 1980-2 C.B. 702, at 705. Section 414(m) requires that all the members of an affiliated service group be treated as one employer for purposes of determining if certain requirements of section 401(a), and the requirements of sections 408(k), 410, 411, and 415 have been met. For plans not in existence on November 30, 1980, section 414(m) is effective for plan years ending after November 30, 1980. For plans in existence on November 30, 1980, section 414(m) is effective for plan years beginning after November 30, 1980.

Rev. Proc. 81-12, 1981-1 C.B. 652, sets forth procedures to be followed in obtaining a determination letter with respect to the impact of section 414(m) of the Code on a particular employee benefit plan or ruling as to whether a taxpayer is a member of an affiliated service group. Rev. Proc. 81-12 also sets forth the time within which a plan must be amended to comply with the requirements of section 414(m).

Notice 82-7, page 14, this Bulletin, provides the time period within which master or prototype plans, pattern plans, basic plans and field prototype plans must be amended to comply with section 414(m) of the Code.

In order to ease the administrative burden on employers who maintain an individually designed plan the Internal Revenue Service has concluded that such an employer will be treated as having timely amended the plan to comply with section 414(m) of the Code if the employer amends the plan to comply with that section by the latest of:

(1) December 31, 1983:

(2) The last day of the first plan year beginning after December 31, 1982;

(3) The last day of the sixth month after the month in which the employer obtains a National Office ruling on whether it is a member of an affiliated service group, provided such ruling is requested by December 31, 1982.

The above guidelines provide the time within which the plan must be amended for section 414(m); however, all amendments to comply with section 414(m) must be made effective from the first day of the first plan year for which section 414(m) applies to that plan.

Guidance for meeting the requirements of section 414(m) of the Code is provided in Rev. Rul. 81-105, 1981-1 C.B. 256.

Plan Amendments to Comply with Final Regulations

Notice 82-9

This Notice provides the time period within which master, prototype, pattern, basic, and field prototype plans must be amended to comply with final Income Tax Regulations under sections 415 and 401(j) of the Internal Revenue Code. This notice also describes the extent to which certain electing small business (Subchapter S) corporations may rely on a previously issued determination letter.

In conjunction with the publication in the Federal Register of January 7, 1981, of final regulations under section 415 of the Code, Notice 81-2, 1981-1 C.B. 613, extended the time for adopting plan amendments to comply with the final regulations. Such plan amendments must be adopted by the end of the 415 transition period, and the amended plan must satisfy the regulations for all limitation years beginning after the transition period.

The transition period is the period beginning with the first plan year beginning after January 7, 1981, and ending on the last day of the earlier of (a) the first plan year beginning after December 31, 1983, or (b) the first plan year for which the plan sponsor or administrator requests, after February 6, 1981, a determination letter. The regulations are immediately effective for any plan not in existence on February 6, 1981.

Under section 1.401(j)-6(b) of the regulations, published in the Federal Register on January 23, 1981, a transitional rule is provided. The rule provides that a plan will be treated as satisfying the requirements of section 401(j) of the Code for plan years beginning prior to January 23, 1982, if for such years, any excess of the benefit accruing under the plan over the maximum benefit permitted for a participant under section 401(j) for such year is used, to the extent reasonably possible, to reduce the maximum benefit permitted under section 401(j) for plan years beginning on or after such date (see the examples under section 1.401(j)-6(b)(4) of the regulations). The transitional rule will apply to a plan only if it is amended to satisfy the requirements of section 401(j) by the beginning of the first plan year beginning on or after January 23, 1982.

Any adopting employer of a master, prototype, pattern, basic, or field prototype plan will be considered as timely amending the plan to comply within the time periods specified in Notice 81-2 or section 1.401(j)-6(b) of the regulations if the employer's plan is amended to comply within the time period stated in this Notice. However, the plan must also comply with the other requirements of Notice 81-2 or section 1.401(j)-6(b).

Where amendments that are designated as conforming a master, prototype, pattern, basic, or field prototype plan to the final regulations under section 415 or 401(j) of the Code are submitted to the Service by December 31, 1982, and adopting employer will have until the later of (a) the end of the sixth calendar month from the time the Service issues an opinion, notification, or determination letter (for a basic plan), or (b) the last day of the first plan year beginning after December 31, 1983, to adopt such amendments. For section 415 of the Code, such amendments must be effective for all limitation years beginning after the date by which such amendments must be adopted. For section 401(j), such amendments must be effective for all plan years beginning on or after the date such amendments are adopted; any excess benefits accruing prior to adoption of the amendments must be treated in accordance with section 1.401(j)-6(b) of the regulations.

All master, prototype, pattern, basic, or field prototype plans for which a request for an initial opinion, notification, or determination letter is submitted after the date of publication of this Notice must comply immediately with the final regulations under sections 415 and 401(j) of the Code or, in the case of plans otherwise subject to the rules of section 401(j), exclude participants subject to section 401(j).

If an electing small business (Subchapter S) corporation, as defined in section 1371(b) of the Internal Revenue Code, that has adopted or amended a master, prototype, field prototype, or basic defined benefit plan and the Subchapter S status of the corporation was not brought to the attention of the district office in its application for a determination letter, such corporation cannot rely on that determination letter with regard to whether the plan satisfies the requirements of section 401(j) for plan years that begin on or after December 31, 1983.

Additionally, if at the time the determination letter was issued, the employer was not a Subchapter S corporation, but subsequently elected Subchapter S status, the corporation cannot rely on that determination letter with regard to whether the plan satisfies the requirements of section 401(j) of the Code for plan years that begin after December 31, 1983.

List of Countries Requiring Cooperation With an International Boycott

Notice 82-10

In order to comply with the mandate of section 999(a)(3) of the Internal Revenue Code of 1954, the Department of the Treasury is publishing a current list of countries which may require participation in, or cooperation with, an international boycott (within the meaning of section 999(b)(3) of the Internal Revenue Code of 1954). The list is the same as the prior quarterly list published in the Federal Register.

On the basis of the best information currently available to the Department of the Treasury, the following countries may require participation in, or cooperation with, an international boycott (within the meaning of section 999(b)(3) of the Internal Revenue Code of 1954).

Bahrain
Iraq
Jordan
Kuwait
Lebanon
Libya
Oman
Qatar
Saudi Arabia
Syria
United Arab Emirates
Yeman, Arab Republic
Yemen, Peoples Democratic Republic of

JOHN E. CHAPOTON,
Assistant Secretary for Tax Policy.

March 30, 1982.

(Filed by the Office of the Federal Register on April 1, 1982, 8:45 a.m., and published in the issue of the Federal Register for April 2, 1982, 47 F.R. 14269)

Income Tax; Taxable Years Beginning After December 31, 1953; Percentage To Be Used by Foreign Life Insurance Companies in Computing Income Tax for the Taxable Year 1981 and Estimated Tax for the Taxable Year 1982

Notice 82-11

(Also Part I, Section 819; 1.819-2.)

AGENCY: Internal Revenue Service, Treasury.

ACTION: Proclamation.

SUMMARY: This proclamation announces the percentage to be used to compute the income tax liability of foreign corporations carrying on life insurance business in the United States.

EFFECTIVE DATE: March 15, 1982.

FOR FURTHUR INFORMATION CONTACT: Mr. Hudson Milner, Office of Tax Analysis, U.S. Treasury Department, Washington, D.C. 20220 (202-566-2705), not a toll free call.

SUPPLEMENTARY INFORMATION: This proclamation, issued each year by the Secretary of the Treasury, announces the percentage to be used to compute the income tax liability of foreign corporations carrying on life insurance business in the United States.

PROCLAMATION

For purposes of computing the 1981 income tax of foreign corporations carrying on a life insurance business, a percentage of 16.5 shall be used in determining the "minimum figure" under section 819. The same percentage shall be used for purposes of computing the estimated tax and the installment payments of estimated tax for the taxable year 1982. No additions to tax shall be made because of any underpayment of estimated tax for the taxable year 1982 which results solely from the use of this percentage.

This proclamation is issued without notice and public procedure because the public cannot effectively participate in the determination of the percentage. It is computed from information contained in income tax returns that are not open to the public. The proclamation was not published prior to its effective date because the percentage is computed on the basis of data which was not then available.

JOHN E. CHAPOTON,
Assistant Secretary,
Tax Policy.

April 2, 1982.

(Filed by the Office of the Federal Register on April 7, 1982, 8:45 a.m., and published in the issue of the Federal Register for April 8, 1982, 47 F.R. 15122)

Certification Regarding the State of New Hampshire Under the Federal Unemployment Tax Act

Notice 82-12

The Secretary of Labor has certified to the Secretary of the Treasury the State of New Hampshire and its unemployment compensation laws under Sections 3303 and 3304 of the Federal Unemployment Tax Act, for the taxable year 1978. The certifications were made in a letter of December 11, 1981, to the Secretary of the Treasury, which is printed below.

DEPARTMENT OF LABOR
SECRETARY OF LABOR
WASHINGTON, D.C.

Honorable Donald T. Regan.
Secretary of the Treasury,
Washington, D.C. 20220
December 11, 1981.

Dear Mr. Secretary:

This is in reference to the previous letter of January 19, 1981, concerning the conditional certifications for 1978 with respect to New Hampshire under Sections 3303(b) and 3304(c) of the Internal Revenue Code of 1954.

The conditions for making those certifications have been met, and the certifications made in that letter, therefore, have become final, and are effective as of October 31, 1978. The Department of Labor is closing its files on the 1978 New Hampshire case.

The cooperation of your Department throughout this matter is greatly appreciated.

Sincerely,

Raymond J. Donovan.

Questions and Answers Relating to Amendments to the Employee Plans Provisions of the Internal Revenue Code by the Economic Recovery Tax Act of 1981 (P.L. 97-34)

Notice 82-13

This Notice provides explanations, questions and answers relating to certain employee plans aspects of the recently enacted Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256] (ERTA).

Until applicable regulations are published, the guidance provided by the explanations, questions and answers in this Notice may be relied on to resolve the issues that are specifically considered. However, plans utilizing the explanations and answers in this Notice may have to be amended subsequently to include or revise provisions to meet the requirements of regulations subsequently adopted. Furthermore, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered when applying the explanations, questions and answers.

A table of contents of the explanations, questions and answers is provided.

All citations in this Notice are to the Internal Revenue Code of 1954, as amended by ERTA.

TABLE OF CONTENTS

I. Individual Retirement Accounts and Voluntary Deductible Contributions
  A. Explanation
  B. Questions and Answers I-1 through I-25
II. Keogh Plans and SEPs
  A. Explanation
  B. Questions and Answers II-1 through II-7
III. Miscellaneous
  A. Investments in Collectibles
    1. Explanation
    2. Questions and Answers III-1 through III-5
  B. "Made Available" Concept

I. *Individual Retirement Accounts and Voluntary Deductible Contributions*

A. Effective for taxable years beginning after December 31, 1981, ERTA amended the Internal Revenue Code to increase the maximum annual deduction for amounts paid to an Individual Retirement Arrangement (IRA) to the lesser of $2,000 or 100 percent of compensation (including earned income). The previous deduction limit was the lesser of $1,500 or 15 percent of compensation. ERTA also amended the Code to permit an active participant in a qualified plan to make deductible contributions to an IRA.

The maximum deductible limit for IRA contributions by an individual with a spouse who has no compensation for the taxable year (unemployed spouse) was raised to $2,250 and the previous requirement that contributions be equally apportioned between the IRAs of the spouses was eliminated. However, not more than $2,000 may be contributed to the IRA of either spouse.

If an IRA has been established for the unemployed spouse and a divorce ensues, the unemployed spouse may make deductible contributions to the IRA if certain conditions are met. In general, the divorced spouse may deduct the lesser of $1,125 or the sum of compensation includible in gross income for the year plus alimony received during the year and includible in gross income under a decree of divorce or separate maintenance.

ERTA also provides that in taxable years beginning after 1981, an employee may deduct qualified voluntary employee contributions to certain types of employee plans. Such contributions are deductible only if (1) the plan provides for voluntary employee contributions; (2) the employee does not designate such contributions as other than deductible; and (3) the employer agrees to treat such contributions as deductible. Moreover, ERTA does not require that these deductible voluntary employee contributions (DECs) be accepted by a plan. The plans that may accept DECs are qualified plans, simplified employee pensions (SEPs), plans funded with annuity contracts described in section 403(b) of the Code, and government plans (whether or not qualified).

DECs are permitted up to the lesser of $2,000 or 100 percent of compensation. However, the limitation on DECs and the limitation on IRA contributions are combined so that the total annual deductions for IRA contributions and DECs may not exceed the lesser of $2,000 or 100 percent of compensation.

In order to qualify as a DEC, an employee contribution must be voluntary. Employee contributions that are required as a condition of employment, as a condition of plan participation or as a condition of obtaining additional employer-provided benefits or contributions are mandatory contributions and, therefore, are not deductible.

Distributions of DECs are, generally, taxed in the same manner as distributions from an IRA and are not subject to the tax provisions applicable to other distributions from a qualified plan. Thus, DECs may not be made after age 70½; distributions to an employee who is not age 59½ or disabled are subject to a 10 percent penalty tax; and assignments or pledges by an employee of DECs or loans to an employee of such contributions as well as loans under contracts purchased with such contributions, are treated as distributions to the employee. However, distributions of DECs are not required to commence at age 70½ (except in the case of an owner-employee as required by section 401(a)(9)).

ERTA grants tax free rollover treatment for qualifying distributions of accumulated DECs, including allocable gains on such contributions, but provides that regulations will be issued on accounting for such contributions so that they do not become eligible for additional tax benefits (or freed from limitations) through the use of rollovers.

Because of the special distribution and taxation rules applicable to DECs, separate accounting from other plan contributions may be required to prevent any reporting penalties on the employer or adverse tax consequences to contributing employees.

Although separate accounting may be required, assets attributable to DECs may be commingled with other plan assets. However, whether or not the assets are commingled, because they are plan assets, if the plan is disqualified, then the assets attributable to the DECs will be affected along with the other assets of the trust.

B. Questions and Answers

I- 1. Q. Is a qualified plan required to accept DECs?

A. No. ERTA does not require any qualified plan to accept DECs. Employers and plan sponsors who do not want their plans to accept DECs are not required to amend those plans in order to preclude them from accepting such contributions, regardless of whether the plans permit voluntary employee contributions.

I- 2. Q. If an employer who maintains a plan wants the plan to allow DECs, what action must the employer take?

A. If the plan does not currently provide for voluntary employee contributions, it must be amended in order to accept DECs. If the plan currently provides for voluntary employee contributions, it need not be amended in order to accept DECs although amendments may be desirable in order to preserve certain tax advantages of DECs (see I-3, I-6, I-8). However, even though no amendment is required, an affirmative action by the employer or plan administrator manifesting an intent to accept such contributions is required. For example, the employer could inform participants that the plan will accept such contributions, and describe the method that will be used to designate contributions as DECs.

I- 3. Q. Should a qualified plan maintain separate accounting for DECs?

A. Yes. A plan will not fail to be qualified merely because it fails to separately account for DECs. However, separate accounting may be required to assure that an employee who later receives a distribution from the plan can properly utilize certain beneficial tax provisions and compute the tax on that distribution. Further, failure to properly account for these DECs may also result in reporting penalties being imposed on the employer.

I- 4. Q. Can an employer establish a qualified plan that provides that the only contributions to the plan will be voluntary deductible contributions?

A. Yes. A qualified pension plan may provide that the only contributions to the plan will be employee contributions. Therefore, an employer may establish a pension plan or stock bonus plan that provides only for DECs (and returns to the employee any contribution that is not a DEC). However, although DECs can be made to a profit-sharing plan, a plan that provides only for DECs would not qualify as a profit-sharing plan because it would not be a plan for participation by the employees in the employer's profits.

I- 5. Q. May a plan that permits only DECs limit participation to employees who elect to make such contributions?

A. No. DECs must be voluntary contributions. Contributions that are a condition of participation in a plan are mandatory contributions within the meaning of section 411(c)(2)(C) of the Code and therefore cannot be treated as DECs. However, if, under the plan, all eligible employees are automatically participants (whether or not they contribute), then employee contributions to the plan are not a condition of plan participation or a condition of receiving employer benefits. Therefore, the contributions made to the plan will be voluntary contributions within the meaning of section 219(e)(2)(B).

I- 6. Q. May the plan administrator require employees to designate voluntary contributions as nondeductible prior to making the contributions?

A. Yes. The plan administrator may require that a contribution be designated as either deductible or nondeductible before it is made. On the other hand, the plan administrator may also permit a contribution to be designated as deductible or nondeductible, or permit a prior designation to be changed, at any time until April 15 of the calendar year succeeding the year for which the contribution is made. However, if the employee has not by April 15 designated a contribution as deductible or nondeductible, the contribution must be treated as a DEC.

I- 7. Q. May a qualified plan that provides that the only contributions to the plan will be DECs, treat all employee contributions as DECs, but also provide that, on request by the employee, the employee contributions made with respect to a calendar year and earnings thereon will be redesignated as nondeductible contributions and returned to the employee on or before April 15 of the following calendar year?

A. Yes. Participants' contributions are voluntary contributions and can therefore be withdrawn without restrictions applicable to employer contributions and mandatory employee contributions. The plan may therefore provide that all employee contributions made with respect to a calendar year will be treated as DECs but that, if the employee requests, the contributions, and earnings thereon, may be redesignated as nondeductible contributions and withdrawn by April 15 of the following calendar year. See paragraph 1 of I-9 regarding the taxation of any such distribution and I-19 regarding the treatment of such a redesignation for purposes of section 415 of the Code.

I- 8. Q. What is the effect of the withdrawal of DECs prior to the time when the employee attains age 59½?

A. A retirement plan will not fail to qualify merely because it permits the withdrawal of DECs (and the interest thereon) prior to attainment of age 59½. However, the amount of the withdrawal (including any loan to the participant) is includible in the gross income of the individual, and, if the individual is not over age 59½ or disabled within the meaning of section 72(m)(7) of the Code, results in an increase in the individual's tax equal to 10 percent of the amount of the withdrawal. (See section 72(o)(2).) An exception to this rule is that qualified rollover distributions are neither includible in gross income nor subject to the extra 10 percent tax to the extent they are timely rolled over to another plan or IRA.

I- 9. Q. Will the 10 percent penalty tax in section 72(o)(2) of the Code apply if an individual withdraws DECs made in one year before April 15 of the next year?

A. If the plan allows redesignation of DECs as nondeductible employee contributions, then any amounts that are so redesignated and withdrawn before the April 15 following the year of the contribution will not be subject to the 10 percent penalty tax.

However, any DEC that is redesignated will, for purposes of section 415 of the Code, be treated as a voluntary employee contribution as of the contribution date, whether or not withdrawn. If the plan specifies that a DEC may not be redesignated as a nondeductible contribution, such as a plan that accepts only DECs, then any withdrawal of a DEC will be subject to the 10 percent penalty tax.

I-10. Q. Can a nondeductible voluntary employee contribution that is withdrawn from and recontributed to a plan be treated as a DEC?

A. Yes. A voluntary employee contribution may be a DEC even though it is merely a recontribution to the plan of an amount previously distributed from the plan to the employee. Thus, for example, if a plan distributes to a participant a voluntary contribution made in a prior year (or any investment earnings thereon), that amount may be recontributed to the plan and deducted to the extent allowed under section 219 of the Code. However, any such distribution will be taxed as a plan distribution.

I-11. Q. May a plan provide that DECs will be accepted from any current employee?

A. Yes. If the plan so provides, any individual may be allowed to make DECs for a calendar year he or she was employed by the employer maintaining the plan in that year. This is allowed whether or not the employee otherwise participates in the plan.

I-12. Q. Must DECs be distributed to an employee at the time the individual separates from service?

A. No. The plan need not (but may) provide that DECs will be distributed to an individual merely because the individual separates from service with the employer. However, see I-8 and I-24 regarding the possible tax consequences of such a distribution. A plan may limit the distribution of DECs in any manner that is permissible with respect to the distribution of other voluntary contributions.

I-13. Q. May an employee make a deductible voluntary contribution to a qualified plan on behalf of an unemployed spouse?

A. No. The provision for deducting IRA contributions on behalf of a spouse has not been extended to voluntary contributions under a qualified plan. Therefore, DECs may be made only on behalf of the employee. However, the employee is permitted to make DECs to the employer's plan on his or her own behalf and, in addition, establish a spousal IRA for the unemployed spouse. The overall limit on deductions would be the same as if the working spouse had established an IRA on his or her own behalf instead of making DECs to a qualified employer plan.

I-14. Q. Must a plan that accepts DECs restrict the distribution of the accumulated DECs as provided in section 1.401-1(b)(1)(i) and (ii) of the Income Tax Regulations?

A. No. Sections 1.401-1(b)(1)(i) and 1.401-1(b)(1)(ii) of the regulations restrict the circumstances in which a qualified pension plan or a qualified profit-sharing or stock bonus plan may permit distributions to plan participants. However, voluntary employee contributions (and any investment experience thereon) are not subject to these restrictions. Thus, a plan need not impose these restrictions on the accumulated DECs in order to maintain its qualified status.

I-15. Q. Is the limitation on voluntary employee contributions to a qualified plan of 10 percent of an employee's compensation reduced by the amount of DECs?

A. No. The 10 percent limitation applies to non-deductible contributions only, not to

DECs. Therefore, a plan which provides for DECs may also provide for voluntary nondeductible employee contributions of up to 10 percent of compensation.

I-16. Q. How is it determined whether the opportunity to make DECs is reasonably available to a nondiscriminatory group of employees?

A. If a plan permits participants to make DECs, the opportunity to make such contributions must be reasonably available to a nondiscriminatory group of employees. The availability standard will be satisfied if a nondiscriminatory group of employees is eligible to make DECs under the terms of the plan and if a nondiscriminatory group of employees actually have the opportunity to make DECs when plan restrictions are taken into account.

A nondiscriminatory group of employees is eligible to make DECs under the terms of the plan if the group either meets the percentage requirements of section 410(b)(1)(A) of the Code or comprises a classification of employees that does not discriminate in favor of employees who are officers, shareholders, or highly compensated, as provided in section 410(b)(1)(B).

In some cases, an employee may not be permitted to make deductible contributions until a plan restriction (such as making a certain level of mandatory employee contributions) is satisfied. In this case, it is necessary to determine whether a nondiscriminatory group of employees actually have the opportunity to make DECs. For this purpose, only employees who have satisfied the plan restriction will be considered to have the opportunity to make deductible contributions. Thus, for example, if a plan requires an employee to make mandatory contributions of 6 percent of compensation in order to make DECs, and if only a small percentage of employees make the 6 percent mandatory contributions, then the group of employees who have the opportunity to make DECs may not satisfy either test under section 410(b). In the case of an integrated plan employees who are excluded from participation in such a plan because they earn less than the integration level amount will be taken into account in determining whether a nondiscriminatory group of employees actually have the opportunity and make DECs.

If the availability standards are met, and if the deductible contributions permitted are not more favorable, as a percentage of compensation, for officers, shareholders or highly compensated employees than for other participants, the DEC feature will meet the requirement that contributions and benefits not discriminate in favor of employees who are officers, shareholders, or highly compensated. This is so because the contributions are made by the employee, not the employer.

I-17. Q. Is a plan provision that limits DECs to a stated percentage (such as 10 percent) of compensation discriminatory in favor of employees who are officers, shareholders, or highly compensated?

A. No. The maximum amount of voluntary employee contributions that may be deducted is the lesser of $2,000 or 100 percent of compensation but an employer need not permit employees to make the maximum deductible contribution to a plan so long as the plan provisions do not otherwise result in discrimination in favor of employees who are officers, shareholders, or highly compensated. A limitation on DECs to a stated percentage of compensation that applies equally to the compensation of all employees is nondiscriminatory so long as the right to make such DECs is reasonably available to a nondiscriminatory group of employees.

I-18. Q. Are contributions to an IRA (other than employer contributions under a SEP) or DECs part of the annual addition, within the meaning of section 415 of the Code?

A. No. These contributions are not considered in applying the limitations under section 415(c) or (e) of the Code for any years.

I-19. Q. Does a qualified voluntary employee contribution not in excess of $2,000 become an annual addition to a plan to the extent it is not deductible?

A. Yes. A DEC is not an annual addition. However, to the extent the contribution is not deductible it will be an annual addition under section 415(c)(2). Such nondeductible voluntary contributions are treated the same way as other nondeductible voluntary contributions. However, qualified voluntary employee contributions not in excess of $2,000 that would cause the limitation on annual additions to be exceeded will not be treated as annual additions to the extent the portion of the contribution exceeding the limitation (and earnings thereon) is returned to the employee as soon as administratively feasible.

I-20. Q. Must the maximum limitation on DECs to an employer-sponsored plan or on deductions for contributions to an IRA be reduced by amounts excluded from an individual's income for the purchase of an annuity contract under section 403(b)?

A. No. The maximum limitations on DECs and on deductions for IRA contributions are determined without regard to any amounts excluded under the section 403(b) exclusion allowance. This is so even if an individual's DECs are made to an annuity contract described in section 403(b).

I-21. Q. Are DECs made by payroll deduction subject to income tax withholding and taxes imposed by the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA)?

A. An employer need not withhold income tax on DECs that are made by payroll deduction. However, payroll deduction employee contributions to employee plans and SEPs, unlike employer contributions, are subject to FICA and FUTA. This is true even though the employee contributions are deductible for Federal income tax purposes.

I-22. Q. Can DECs be deducted if made with respect to a year for which a plan has been disqualified?

A. No. When a plan (except for a government plan) loses its qualified status for a year, voluntary contributions made for that year, and any following year when the plan is not qualified, are not deductible. However, see I-4, regarding plans that accept only DECs.

I-23. Q. What is the employee's basis in DECs when the contributions are subsequently distributed to the employee from the plan?

A. The employee has a zero basis in the contributions.

I-24. Q. May DECs be rolled over to an IRA and/or to another qualified plan?

A. Yes. DECs to a qualified plan are generally eligible to be rolled over to another qualified plan or to an IRA. The exception to this rule is that DECs made on behalf of self-employed individuals to qualified plans are only eligible for rollover to an IRA. DECs to an IRA under a SEP are eligible for rollover only to an IRA. Other rules concerning rollovers of DECs may be prescribed under section 72(o)(4) of the Code.

I-25. Q. Does a distribution that would otherwise constitute a lump sum distribution lose its eligibility for capital gain or 10-year averaging treatment if DECs are retained by the plan?

A. No. DECs are not eligible for capital gain or 10-year averaging treatment and are not a part of the balance to the credit of the employee that is required to be distributed as part of a lump sum distribution.

II. *Keogh Plans and SEPs*

A. ERTA changed some of the requirements for Keogh plans and for Simplified Employee Pensions (SEPs). These changes, unless otherwise indicated, are effective for plan years (for qualified retirement plans where the employer has a calendar taxable year) or calendar years (for SEPs) beginning after December 31, 1981.

ERTA increased the maximum deductible contribution that may be made to a defined contribution Keogh plan or to a SEP to the lesser of 15% of compensation (or earned income in the case of a self-employed individual) or $15,000.

For defined benefit Keogh plans, ERTA increased from $50,000 to $100,000 the amount of compensation that may be taken into account for determining unreduced annual benefit accruals under section 401(j) of the Code.

ERTA increased to $200,000 the maximum compensation that may be taken into account for determining contributions under SEPs and under plans that provide for contributions or benefits on behalf of shareholder employees of Subchapter S Corporations or self-employed individuals. However, if compensation in excess of $100,000 is taken into account in a SEP or a defined contribution plan (including a target benefit plan), contributions on behalf of certain employees must be at a rate (expressed as a percent of compensation) not less than 7.5 percent. If a defined benefit Keogh plan takes into account compensation in excess of $100,000, the annual benefit accrual for common law employees must be a percentage which is not less than one-half of the applicable percentage under section 401(j) of the Code for a similar self-employed individual.

ERTA also treats a loan by a Keogh plan to a self-employed individual, as well as pledges or assignments by such an individual of his or her interest under such a plan, as a distribution. This provision applies to loans, assignments or pledges made after December 31, 1981. Prior provisions for treating loans, assignments, or pledges as distributions applies only to the plan interest of an owner-employee.

ERTA permits the correction of an excess contribution to a Keogh plan without penalty if the excess is withdrawn before the due date for filing the tax return, including extensions, if applicable.

Finally, a distribution to an owner-employee prior to age 59½ will no longer prevent contributions on behalf of such owner-employee to any plan for the succeeding five taxable years if the distribution was from a terminated plan.

B. Questions and Answers

II-1. Q. May an employee make DECs to a Keogh plan or to a SEP?

A. Yes. Both types of plans may receive DECs if the requirements discussed in Part I of this Notice are met.

II-2. Q. If an owner-employee receives a distribution, other than a distribution of voluntary contributions from a defined contribution Keogh plan, when the owner-employee is not at least 59½ years old or disabled, may contributions continue to be made on behalf of the owner-employee?

A. No. ERTA removes the 5-year ban on contributions only in the case of a distribution upon plan termination. It does not alter the penalty applicable to other premature distributions.

II-3. Q. Is a distribution of an excess contribution by a defined contribution Keogh plan to an owner-employee who is not disabled and has not attained age 59½ a premature distribution if the distribution occurs prior to the due date of the employer's tax return (or information return in the case of a partnership)?

A. No. The distribution is not a premature distribution nor is it a contribution for the purposes of the tax on excess contributions.

II-4. Q. In a defined benefit Keogh plan, how does a change in annual compensation taken into account affect the limitations on the accrual of benefits?

A. A change in annual compensation used for determining the accrual of benefits will be treated as beginning a new period of plan participation.

II-5. Q. Is the maximum deduction for a contribution to a SEP reduced by contributions made by the participant to an IRA?

A. No. Under ERTA the limitations on employer contributions to a SEP and employee contributions to an IRA are applied separately. Furthermore, a single IRA will not be considered to violate section 408 merely because it accepts contributions in one year of $15,000 under a SEP and $2,000 as an IRA contribution.

II-6. Q. If a Keogh plan takes into account compensation in excess of $100,000), can the plan still be integrated with Social Security?

A. Yes. In an integrated Keogh plan, taxes paid under section 3111(a) with respect to an employee are taken into account as contributions by the employer for such employee. Contributions, including amounts deemed contributed under the plan's integration formula, on behalf of a common law employee must be at a rate not less than 7.5 percent of compensation (as defined under the plan) if compensation in excess of $100,000 is taken into account.

II-7. Q. When does the new $15,000 limit on deductions for contributions to Keogh plans apply to a partnership, whose taxable year ends on June 30?

A. The new limits apply for taxable years of the partnership beginning after December 31, 1981. Therefore, the new limits will first be available for the partnership's taxable year beginning July 1, 1982. The effective date of the new rules is determined without regard to the taxable year of a partner.

III. *Miscellaneous*

A. *Investments in Collectibles*

1. For taxable years ending after December 31, 1981, the acquisition of a "collectible" by an individually-directed account under a plan described in section 401(a), or by an individual retirement account (whether or not individually-directed), is treated as a distribution from the plan or account.

2. *Questions and Answers*

III-1. Q. What is a collectible?

A. The term "collectible" includes: (a) any work of art; (b) any rug or antique; (c) any metal or gem; (d) any stamp or coin; (e) any alcoholic beverage; or (f) any other tangible personal property that may be specified by the Secretary of the Treasury for this purpose.

III-2. Q. What is an individually-directed account?

A. The term "individually-directed account" means an account under a qualified plan that provides for individual accounts and that has the effect of permitting a participant or beneficiary to direct the manner in which his or her account will be invested.

III-3. Q. What is the effect of the new requirement on collectibles that were acquired on or before December 31, 1981?

A. Since the new provision is not applicable to collectibles that were acquired on or before December 31, 1981, the retention of a collectible acquired prior to January 1, 1982 by an IRA or an individually-directed account is not treated as a distribution.

III-4. Q. If an owner-employee who has not attained age 59½ directs the investment in a "collectible" by his or her individually-directed account, is the owner-employee liable for the penalties on premature distributions?

A. Yes. An investment in a collectible by an individually-directed account is treated as a distribution from the plan and is subject to the premature distribution penalty if the participant is not age 59½ or disabled. A similar conclusion would apply in the case of an IRA.

III-5. Q. Is the acquisition of a collectible by a plan treated as a distribution to the plan participant if the participant has the authority to direct that assets in the participant's account will be invested in collectibles but has no authority to direct that a specific investment be acquired?

A. Yes. An account is "individually directed" for purposes of this provision even if the participant's control over the assets in the participant's account is limited to the authority to determine that such assets will be used to acquire a class of collectibles even if it does not permit the participant to identify specific investments within that class.

B. *"Made Available" Concept*

ERTA eliminates the provision for taxing participants and their beneficiaries on amounts "made available" under qualified plans. Thus, amounts that are made available, but not yet distributed from the plan, generally will not be taxable to the participant until actually distributed. Regulations under sections 402(a) and 403(a)(1) of the Code will be amended to delete provisions that require amounts to be taxed when they are "made available" but not distributed. Many plans contain election or penalty provisions that were designed solely to prevent amounts from being made available to plan participants before they are actually distributed. These plan provisions are no longer required in order to avoid taxation of participants on amounts that have not been distributed from the plan.

However, certain restrictions on distributions are required for a particular retirement plan to be qualified. (See, for example, sections 1.401-(b)(1)(i) and (ii) and 1.401-4(c) of the Income Tax Regulations and section 401(d)(4)(B) of the Code.) Deletion of the restrictions required for the plan to be qualified will result in the loss of favorable tax treatment. Furthermore, if the removal of restrictions on distributions leads to withdrawals which cause the plan to operate primarily for the benefit of employees who are officers, shareholders, or highly compensated, the plan will lose its qualified status.

Inflation Adjustment for Computation of Windfall Profit Tax

Notice 82-14

Section 4989(b) of the Internal Revenue Code requires the determination of an inflation adjustment factor for use in computing the windfall profit tax.

The Service has determined that, for oil removed during the July - September quarter of 1982, the inflation adjustments are as follows:

Tier 1 or Tier 2 oil	0.2523
Tier 3 oil	0.3230

Worksheets for computation of the windfall profit tax are included in the Instructions for Form 6047, Windfall Profit Tax, and an explanation of the inflation adjustment may be found in the Specific Instructions for Line 4 of the worksheets.

---

26 CFR 601.602: Forms and instructions.
(Also Part I, Section 3302; 31:3302(c)-1.)

Rev. Proc. 82-1

SECTION 1. PURPOSE

The purpose of this revenue procedure is to bring up to date the procedure to be followed in computing reductions in the credit against the tax reportable on Form 940, Employer's Annual Federal Unemployment Tax Return, for 1981.

SEC. 2. BACKGROUND

.01 Section 3301 of the Internal Revenue Code imposes an excise tax on employers based on wages paid to employees. Section 3306(a) defines the term "employer" for purposes of the tax imposed by section 3301.

.02 Section 3302 of the Code provides for credits against the tax imposed by section 3301. Reductions in the amount of credit otherwise allowable are provided for in section 3302(c). Section 3302(c)(2) provides that reductions shall occur if an employer pays wages for services performed in a state that has not restored amounts that were advanced under Title XII of the Social Security Act, 42 U.S.C. sections 1321-1324(1976).

.03 Section 3302(c)(2)(A) of the Code, in conjunction with section 3302(d), provides that for each consecutive calendar year beginning with the second consecutive calendar year in which the advances have not been repaid, the reduction is equal to 0.3 percent of the wages (as defined in section 3306(b)) paid.

.04 Section 3302(c)(2)(B) of the Code provides for an additional reduction for the third or fourth consecutive year in which the advances have not been repaid if the average contribution rate for such state for the preceding year is less than 2.7 percent. Section 3302(d)(7) provides that the percentage of the additional reduction is determined by the Secretary of Labor.

.05 Section 3302(f) of the Code (added by section 2406(a) of the Omnibus Budget Reconciliation Act of 1981, Pub. L. 97-35, 1981-2 C.B. 528) provides a cap on credit reductions in the case of any state that meets certain solvency requirements, as determined by the Secretary of Labor on or before November 10. The credit reduction applicable to employers subject to the unemployment compensation law of that state is limited to either 0.6 percent of wages paid or the percentage credit reduction that was in effect in the case of the state for the preceding taxable year, if greater than 0.6 percent.

06 Section 3302(d)(3) of the Code provides that credit reductions for any year may be forestalled if a state restores to the United States Treasury, before November 10 of that year, the full amount of the advances.

.07 For purposes of the tax imposed by section 3301 of the Code, section 3306(j)(1) provides that the term "State" includes the District of Columbia, the Commonwealth of Puerto Rico, and the Virgin Islands.

SEC. 3. CREDIT REDUCTIONS FOR 1981

.01 As of November 10, 1981, employers subject to the unemployment compensation laws of the Commonwealth of Puerto Rico, the District of Columbia, the Virgin Islands, and the States of Connecticut, Delaware, Illinois, Maine, New Jersey, Pennsylvania, Rhode Island, and Vermont had not repaid the advances and were subject to credit reductions of at least 0.6 percent under section 3302(c)(2)(A) of the Code. On November 19, 1981, the Secretary of Labor advised the Secretary of the Treasury that all six "states" affected by the cap on credit reductions (Connecticut, Delaware, the District of Columbia, Pennsylvania, Rhode Island, and Vermont) met the solvency requirements of section 3302(f) of the Code and that employers in the other five "states" were subject to credit reductions of 0.6 percent.

.02 For the taxable year 1980, a credit reduction of 0.7 percent of the wages (as defined in section 3306(b) of the Code) was in effect for wages that were attributable to the State of Connecticut. None of the other "states" had a credit reduction of greater than 0.6 percent in effect for the taxable year 1980.

.03 Therefore, credit reductions will take effect in the amount of 0.6 percent of the wages (as defined in section 3306(b) of the Code) paid by employers during 1981 that are attributable to the Commonwealth of Puerto Rico, the District of Columbia, the Virgin Islands, and the States of Delaware, Illinois, Maine, New Jersey, Pennsylvania, Rhode Island, and Vermont. Further, credit reduction will take effect in the amount of 0.7 percent of the wages (as defined in section 3306(b)) paid by employers during 1981 that are attributable to the State of Connecticut.

SEC. 4. PROCEDURE

.01 If a credit reduction applies, it is computed on Part I, lines 6 and 7, of the Form 940 for 1981, and carried to line 2, part II or line 4, Part III.

---

26 CFR 601.201: Rulings and determination letters.
(Also Section 501; 1.501(c)(3)-1.)

Rev. Proc. 82-2

SECTION 1. PURPOSE

The purpose of this revenue procedure is to identify the states and circumstances in which the Service will not require an express provision for the distribution of assets upon dissolution in an exempt organization's articles of incorporation, trust instrument, or other organizing document to satisfy the "organizational" test in section 1.501(c)(3)-1(b)(4) of the Income Tax Regulations. Also, this procedure provides a sample of an acceptable dissolution provision for organizations that are required to have an express provision for the distribution of assets upon dissolution.

SEC. 2. BACKGROUND

.01 Section 1.501(c)(3)-1(b)(4) of the regulations provides that:

> (4) *Distribution of assets on dissolution.* An organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. An organization's assets will be considered dedicated to an exempt purpose, for example, if, upon dissolution, such assets would, by reason of a provision in the organization's articles or by operation of law, be distributed for one or more exempt purposes, or to the Federal government, or to a State or local government, for a public purpose, or would be distributed by a court *to another organization to be used in such manner as in the judgment of the court will best accomplish the general purposes for which the dissolved organization was organized.* However, an organization does not meet the organizational test if its articles or the law of the State in which it was created provide that its assets would, upon dissolution, be distributed to its members or shareholders. [Emphasis added.]

.02 The issue of the applicability of state law in relation to section 1.501(c)(3)-1(b)(4) of the regulations as to a particular organization arises only where the organization itself has not provided for the distribution of its assets upon dissolution in its articles of incorporation, organizing document, or trust instrument. When state law satisfies the provisions of section 1.501(c)(3)-1(b)(4), it is not necessary to require an organization to amend its articles of incorporation or organizing document, or to require a trust to obtain a judicial decree amending its trust instrument, in order to satisfy the organizational test for qualification as an exempt organization described in section 501(c)(3) of the Code, where all the other requirements for exemption are met.

.03 The issue of whether section 1.501(c)(3)-1(b)(4) of the regulations is satisfied under state law can be broken down into four areas according to the type of entity involved:

(1) the *cy pres* doctrine as to *inter vivos* charitable trusts;
(2) the *cy pres* doctrine as to testamentary charitable trusts, which can exist in a particular state by case law and/or by statute;
(3) state corporate law containing statutes that provide for the distribution of assets upon the dissolution of nonprofit corporations; and
(4) state law by court decision or statute relating to unincorporated associations.

Each of these four areas will be treated separately in this revenue procedure.

SEC. 3. GUIDELINES

.01 Inter Vivos Gharitable Trusts.

1 Because there is no guarantee under the law of any jurisdiction, except Delaware, that *cy pres* would be used to keep an *inter vivos* charitable trust from failing, any *inter vivos* charitable trust, except in Delaware, should be required to have an adequate dissolution provision in its trust instrument to satisfy the requirements of section 1.501(c)(3)-1(b)(4) of the regulations.

.02 Testamentary Charitable Trusts.

1 The courts in the following states always apply the *cy pres* doctrine or the doctrine of equitable approximation to keep a charitable testamentary trust from failing, and thus section 1.501(c)(3)-1(b)(4) of the regulations with respect to charitable testamentary trusts is satisfied:

Alabama
Delaware
Louisiana
Pennsylvania
South Dakota
Virginia
West Virginia (However, a state court decision has held that the *cy pres* doctrine does not apply to a scientific organization in West Virginia.)

2 The courts in the jurisdictions listed below will apply the *cy pres* doctrine to keep a charitable testamentary trust from failing when the language of the trust instrument demonstrates that the settlor had a general intent to benefit charity, and not merely a specific intent to benefit a particular institution. In such jurisdiction the *cy pres* doctrine may be relied upon by a charitable testamentary trust to satisfy section 1.501(c)(3)-1(b)(4) of the regulations only when the settlor has demonstrated a general charitable intent in the language of the trust instrument. Unless the testator manifests a general intent to benefit charity, the Service will require the testamentary charitable trust to provide an express dissolution provision in the trust instrument to satisfy section 1.501(c)(3)-1(b)(4).

Arkansas
California
Colorado
Connecticut
District of Columbia
Florida
Georgia
Illinois
Indiana
Iowa
Kansas
Kentucky
Maine
Maryland
Massachusetts

Michigan
Minnesota
Mississippi
Missouri – MO. ANN. STAT. §352.210.3 satisfies the provisions of section 1.501(c)(3)-1(b)(4) of the regulations while MO. ANN. STAT. §355.230.(3) does not satisfy the requirements.
Nebraska
New Hampshire
New Jersey
New York
North Carolina
Ohio
Oklahoma
Oregon
Rhode Island
Tennessee
Texas
Vermont
Washington
Wisconsin

3 Charitable testamentary trusts in the following states need a dissolution provision in the trust instrument to satisfy section 1.501(c)(3)-1(b)(4) of the regulations because these states have either expressly rejected or have never applied the *cy pres* doctrine:

Alaska
Arizona
Hawaii
Idaho
Montana
Nevada
New Mexico
North Dakota
South Carolina
Utah
Wyoming

.03 Nonprofit Charitable Corporations.

1 The statutes applicable to nonprofit charitable corporations in the states listed below will satisfy the provisions of section 1.501(c)(3)-1(b)(4) of the Regulations:

Arkansas
California
Louisiana
Massachusetts
Minnesota
Missouri
Ohio
Oklahoma

All other states, and the District of Columbia do not have statutes applicable to nonprofit charitable corporations that will satisfy the provisions of section 1.501(c)(3)-1(b)(4). Thus, nonprofit corporations in the eight named states do not need a dissolution provision to satisfy section 1.501(c)(3)-1(b)(4). A nonprofit corporation in a jurisdiction not listed needs an adequate dissolution provision in its organizing document to satisfy section 1.501(c)(3)-1(b)(4).

.04 Unincorporated Nonprofit Associations.

None of the fifty-one jurisdictions provides certainty by statute or case law, for the distribution of assets upon the dissolution of an unincorporated nonprofit association. Therefore, any unincorporated nonprofit association needs an adequate dissolution provision in its organizing document to satisfy the requirements of section 1.501(c)(3)-1(b)(4) of the regulations.

.05 Sample Dissolution Provision.

1 For any organization that needs a dissolution provision in its organizing instrument to satisfy the provisions of section 1.501(c)(3)-1(b)(4) of the regulations, the following language is illustrative of what may be used:

(a) *Upon the dissolution of [this organization], assets shall be distributed for one or more exempt purposes within the meaning of section 501(c)(3) of the Internal Revenue Code, or corresponding section of any future Federal tax code, or shall be distributed to the Federal government, or to a state or local government, for a public purpose.*

.06 Periodic Update.

This Revenue Procedure will be updated periodically as changes in state laws come to the attention of the Service.

---

26 CFR 601.602: Forms and instructions.
(Also Part I, Sections 6001, 6011; 1.6001-1, 1.6011-1.)

Rev. Proc. 82-3

SECTION 1. PURPOSE

This revenue procedure states the Internal Revenue Service (the Service) requirements relating to acceptable privately designed and printed substitute federal tax return forms. It also authorizes the use of the reproduction of official forms and gives direction for the proper completion of returns.

SEC. 2. SCOPE

This revenue procedure is the guide for preparing substitutes for most printed tax forms. This procedure does not include guidance for Form 1040-ES, Form 1042S, the Forms 1087 and 1099 series, and the Form W-2 series. See Sec. 18 to obtain guidance for the excluded forms.

SEC. 3. DEFINITIONS USED HERE

.01 *Substitute Form*. A tax form (or related schedule) that differs in any way from the official version and is intended to replace the entire form that is printed and distributed by the Service. This term also covers those approved substitute forms exhibited in this revenue procedure.

.02 *Printed Form*. A form produced using conventional printing processes. Also, a printed form which has been reproduced by photocopying or similar processes.

.03 *Preprinted Pin-Fed Form*. A printed form that has marginal perforations for use with automated and high-speed printing equipment.

.04 *Computer-Prepared Substitute Form*. A printed form in which the taxpayer's name, address and tax entry information has been printed by a computer, computer-printer or other computer-type equipment, such as word-processing equipment.

.05 *Computer-Generated Substitute Form*. A form that is entirely prepared by the use of a computer printer so that all the line numbers, line captions, and the tax amount data entries are in the same typeface. No graphics appear on the form. (Most tax forms requiring signature may not be computer-generated. Among them are Forms 1040, 1040A, and 1120.)

.06 *Manually Prepared Form*. A printed form on which the taxpayer's name, address, and tax entry information is entered by an individual using a pen, pencil, typewriter, or other nonautomated equipment.

.07 *Graphics*. Those parts of a printed tax form that are not tax amount entries or called-for information. Generally, these are line numbers, captions, instructions, special indicators, borders, rules, and strokes created by typesetting, photographics, photocomposition, etc.

.08 *Acceptable Reproduced Form.* A photocopy of an original form or of an unchanged reproduction proof supplied by the Service. (A reproduction is not a substitute form.)

.09 *Supporting Statement (Supplemental Schedule).* A document providing detailed information to support an entry for a line(s) on an official or approved substitute form and filed with (attached to) a tax return. (A supporting statement is not a tax form and does not take the place of an official form.)

SEC. 4. MESSAGE TO TAX RETURN PREPARERS

.01 IF YOU PLAN TO CHANGE OR MODIFY *ANY* TAX FORMS, YOU MUST FOLLOW INTERNAL REVENUE PROCEDURES, AND, IN MANY CASES, YOU MUST GET OFFICIAL APPROVAL BEFORE USING SUBSTITUTE FORMS. THE SERVICE IS CONTINUING A NATIONWIDE PROGRAM TO IDENTIFY AND CONTACT TAX RETURN PREPARERS USING FORMS WHICH DO NOT CONFORM WITH THIS REVENUE PROCEDURE AND IMPEDE PROCESSING OF THE RETURN.

.02 Additional information you may need regarding computer-prepared or computer-generated substitute forms is in Rev. Proc. 82-4, page 22, this Bulletin. (Order as Publication 1168) You can get this revenue procedure by following instructions in Sec. 19.

SEC. 5. HIGHLIGHTS OF PERMITTED CHANGES AND REQUIREMENTS

.01 THINGS YOU *CAN DO* TO INTERNAL REVENUE SERVICE PRINTED TAX FORMS. PRIOR APPROVAL IS NOT REQUIRED.

1 You can PHOTOCOPY any tax form and use it instead of the official one.

2 You can REPRODUCE ANY CURRENT tax form as cut sheets, snapsets, and marginally-punched, pin-fed forms, so long as you use an official Service version as the master copy. Official versions are supplied by the Service, such as those in the taxpayer's tax package, those in Package X, those printed in revenue procedures, and reproduction proofs sold by the Service.

3 You can ADJUST the graphics on specified areas of printed Forms 1040 and 1040A (and other forms) to allow for computer-printed or word processor fill-in. Guidelines for making these adjustments are listed in Rev. Proc. 82-4. Only the areas listed may be adjusted without specific prior approval.

4 You can PRINT AND DUPLICATE the substitute "worksheet-type" versions of Schedules A and B of Form 1040 (see exhibits). The Service will accept these substitute schedules instead of the official versions. These schedules serve different purposes. One allows the form to contain state tax information which is blocked-out before filing with the Service. The other allows the form to be used singly or as part of a snap-set.

.02 THINGS YOU *CANNOT DO* TO INTERNAL REVENUE SERVICE PRINTED TAX FORMS.

1 You cannot, without prior Service approval, change any Internal Revenue Service tax forms or use your own (non-approved) version, unless specifically permitted by revenue procedure.

2 You cannot adjust any of the graphics on Forms 1040 and 1040A (except in those areas specified in revenue procedures) without prior approval from the Service.

3 Generally, you cannot use your own version of Schedule A (Form 1040) UNLESS YOU FIRST GET IT APPROVED. The Service wants only one Schedule A—either yours or ours; yours needs prior approval from the Service.

4 With some exceptions, you cannot omit filling in pertinent referenced (numbered or lettered) lines of the official Schedule A (and other tax forms) when attaching a supporting statement. Exceptions to line completion requirements are listed in this revenue procedure.

5 You cannot use your own preprinted label on tax returns filed with the Service. The ONLY label permitted is the one provided the taxpayers in their tax packages. Otherwise, the taxpayer's name, address, and other identifying information must be entered on the return in the spaces provided.

SEC. 6. APPROVAL

.01 *Basic Requirements.* Preparers who desire to file privately designed and printed substitute tax forms must develop such substitutes using these guidelines. These substitutes, unless excepted by revenue procedure, must be approved by the Service before being filed.

.02 *Requests for Approval*

1 The Service cannot approve your substitute form until the official form has been published. Please propose your substitute after you have examined the official form.

2 You should know the revenue procedure relating to the official form before you attempt to alter the form to meet your needs. Any alteration of forms must be within the limits acceptable to the Service. It is possible that, from one filing period to another, a change in law or a change in internal need (processing, audit, compliance, etc.) may change the allowable limits for the alteration of the official form.

3 When specific approval of any substitute form is desired, you should send a letter requesting approval and containing a sample of the proposed substitute to the Internal Revenue Service, Attention: Substitute Form Program, TX:R:I, 1111 Constitution Avenue, N.W. Washington, D.C. 20224.

.03 *When to Send Proposed Substitutes.* Proposed substitutes should be sent to the address listed in .02 above, as much in advance of the filing period for the form as possible. This is to allow adequate time for analysis and response and to permit notice to our field offices that your substitute is acceptable. Quarterly filed forms, such as the Form 941, must be submitted by the first day of the last month of the quarter.

.04 *Accompanying Statement.* When the sample substitute is submitted, there should be an accompanying statement that lists the form number of each substitute requested and details those items that deviate from the official form in position, arrangement, appearance, line numbers, additions, deletions, etc. Included with each of the items should be a detailed reason or justification for the change and an approximation of the number of forms expected to be filed.

.05 *Approval/Non-Approval Letter.* The Service sends a formal letter of approval/non-approval. Approval letters may contain qualifications for use of the substitutes. Non-approval letters may specify the changes required for approval, but also require resubmission for approval.

.06 *Duration of Approval.*

1 Approvals are good for only one calendar year (January through December) or, in the case of corporation tax forms (with the exception noted below), for the remainder of the quarters of the calendar year.

2 PLEASE NOTE: In most cases each new filing season requires a new approval, even if the official form does not change. But see the exceptions in 3 and 4 below.

3 Exception: Quarterly tax forms in the 94X series (941, 942, etc.) are approved only for one quarter. Each new quarter requires a new approval.

4 Exception: Limited continued use of a change approved for a tax year 1980 form is allowed for the same form in tax year 1981. See Sec. 6.08 for the limitations and for other requirements.

.07 *Requested Copies.* In our letter of approval, you *may* be requested to send to the Service eleven (11) copies of each approved form. When received, the copies will be used to notify Internal Revenue Service Centers that your substitute forms are approved. The requested forms should be assembled in sets. A set constitutes a return with the related schedules and forms in order as they will be filed, i.e., Form 1040, Schedules A, B, C, etc., Forms 2440, 2441, etc.

.08 *Limited Continued Use of an Approved Change.*

1 If you received written approval of a tax year *1980* substitute form governed by this revenue procedure and wish to continue to use the approved change in your tax year *1981* substitute form, you may revise the official form current in *1981* to include this change and, without additional written approval, use it as a tax year *1981* substitute form, PROVIDED you comply with the requirements in this revenue procedure. SEE EXCEPTION in 2 below.

2 This means that if you received written approval for a specific change on a specific form last year, you may again make the same change on the same form this year. Thus, the change allowed in last year's approved substitute Schedule A, for example, can be continued in your new substitute for this year. The new substitute does not have to be sent to the Service, and written approval is not required. However, the new substitute must conform to the official *1981* form in other respects: for example, it must contain the current date, Office of Management and Budget (OMB) approval number, sequence number, arrangement, item caption, line number, line reference, sequence, etc. It must also comply with this revenue procedure—which may have eliminated, added to, or otherwise changed the guideline which affected the change approved last year. Additionally, you will be bound by the "Agreement" in Section 21.

EXCEPTION: Those written approvals which stated that the approved change or form would not be allowed in any other tax year.

3 This authorization for continued use of an approved change is limited to the continuation from a tax year *1980* substitute form to a tax year *1981* substitute form.

SEC. 7. OFFICE OF MANAGEMENT AND BUDGET (OMB) REQUIREMENTS FOR ALL SUBSTITUTE FORMS

.01 *New Legal Requirements of the Paperwork Reduction Act of 1980.* Public Law 96-511 requires that: (1) OMB approve Service tax forms, (2) each form contain (in the upper right corner) the OMB approval number and any expiration date, and (3) each form (or its instructions) state why the Service is collecting the information, how it will be used, and whether or not the information is required to be furnished.

.02 *Application to Substitute Forms.*

1 *Approval Number and Date Is Required.* All substitute forms must contain in the upper right corner (see Marginal Printing, Sec. 11.02.1(c)) the OMB number and any expiration date that is on the form.

2 *Format Required (3 Options).*

(a) OMB No. XXXX-XXXX (preferred)
    or
    OMB # XXXX-XXXX
(b) OMB No. XXXX-XXXX
    Expires XXXXXX (mmddyy)
    (preferred)
    or
    OMB # XXXX-XXXX
    Expires XXXXXX (mmddyy)
(c) OMB No. XXXX-XXXX
    Expires XXXXXX (mmddyy)
    (preferred)
    or
    OMB # XXXX-XXXX
    Expires XXXXXX (mmddyy).

3 *Required Explanation to Users of Substitute Forms.* You must also inform the users of your substitute forms of the Service use and collection requirements stated in the instructions for the official form.

.03 *Obtaining OMB Number, Date, and Statement.* The OMB approval number, expiration date, and use and collection requirements may be obtained from the printed form (or its instructions), the reproduction proof (or instructions), or from the Service.

SEC. 8. GENERAL GUIDELINES

.01 *Official Form is The Standard.* Because a substitute form is a variation from the official form, you should know the requirements of the official form for the year of use before you modify it to meet your needs. For the most frequently used tax forms, the quickest way to obtain an official form is to request reproduction proofs of these forms. (See Sec. 20.)

.02 *Design.* Each form must follow the design of the official form as to format, arrangement, item caption, line numbers, line references, and sequence.

.03 *State Tax Information Prohibited.* State tax information must not appear (be visible) on the federal tax return which is filed with the Internal Revenue Service Center, except where amounts are claimed on or required by the federal return, e.g., line 11, Schedule A (Form 1040). (See Sec. 12.05, Block Out Methods.)

.04 *Federal and State Columns.* When a form is designed with both federal and state columns, THE FEDERAL COLUMN MUST BE TO THE LEFT OF THE STATE COLUMN AND ADJACENT TO THE LINE CAPTION.

.05 *Vertical Line in Amount Field.* When a form is to be manually prepared, the federal column must have a vertical line or some type of indicator in the amount field to separate dollars from cents if the official form has a vertical line. The cents columns must be at least ⅛-inch wide.

.06 *Sequence Number*. Please note that certain forms have a recently added "sequence number" located just below the year designation in the upper right corner of the form. Form 1040 also has one opposite line 54 on the left side. The Service uses this number to indicate the order in which forms are processed when filed with a return. It must be printed on the affected form, in no less than 12-point, bold-face type and centered below the form's year designation.

.07 *Forms with Sequence Numbers Required*. THE SEQUENCE NUMBER IS REQUIRED ON THE FORMS LISTED BELOW. Please note that some of the numbers have been changed since last year.

Form 1040 Schedule/Form	*Sequence Number*
1040	06 (Left of line 54)
A	07
C	08
D	14
E	15
F (Page 1)	16
(Page 2)	17
G	20
R and RP	21
SE	22
2119	24
2440	25
2441	26
2555	35
3468	27
4136	28
4625	29
4726	30
4797	31
5329	32
5695	33
6251	34

.08 *Paid Preparer's Information and Signature Area*. On all forms, where present, the "Paid Preparer's Use Only" area may not be rearranged or relocated. You may, however, add up to three extra lines to the paid preparer's address area without prior approval.

.09 *Assemblage of Forms*. When filing a return (e.g., Form 1040), we prefer that the return be arranged in this order: (1) the tax return, (2) lettered forms in alphabetical order (Schedule A, B, etc.), (3) the numbered forms shown in .07 above in sequence number order followed by all other numbered forms; (4) supporting statements in the same sequence as the forms they support, and (5) additional information required or voluntarily submitted. In this way, they are received in the order in which they must be processed. If you do not send them in this order, the Service has to disassemble them and place them in this order before processing is continued.

SEC. 9. PHYSICAL ASPECTS AND REQUIREMENTS: PAPER

.01 *Paper Content*. The paper must be:

1 Chemical wood writing paper that is equal to or better than the quality used for the official form;

2 at least 18 pound (17" x 22", 500 sheets) or

3 at least 45 pound (25" x 38", 500 sheets).

.02 *Paper Prohibited*. Carbon-bonded paper is prohibited from use for all forms filed with the Service.

.03 *Paper With Chemical Transfer Properties—LIMITED USE*. Chemical transfer paper may be used ONLY when the following specifications are met:

1 Each ply within the chemical transfer set of forms must be labeled.

2 Only the top ply (ply one and white in color), the one which contains chemical on the back only (coated back), may be filed with the Service. For example, a set containing three plies would be constructed as follows: ply one (coated back) "Federal Return, File with the Internal Revenue Service"; ply two (coated front and back), "Taxpayer's copy"; and ply three (coated front), "Preparer's copy."

3 The file designation, "Federal Return, File with the Internal Revenue Service," for ply one must be printed in the bottom right margin (just below the last line of the form) in 12-point, bold-face type. It is not mandatory, but recommended, that the file designation, "Federal Return, File with the Internal Revenue Service," be printed in a contrasting ink for visual emphasis.

.04 *Carbon Paper*. We prefer that you do not attach any carbon paper to any return you file with the Service.

.05 *Paper and Ink Color*. We prefer that you substantially duplicate the color of the original form. You may, however, use white paper without written approval. Black ink is required. Therefore, your substitute must be printed in black ink, but your paper may be either white or the color of the official form. An exception to this rule is that Forms 1040A and 1040 substitutes and reproductions may be in black ink without the colored screening; any additional exception to this rule requires written approval from the Service.

.06 *Page Size*. Substitute or reproduced forms may be the same size as the official form (8" x 11", in most cases) or they may be the standard commercial size 8½" x 11"). The thickness of the stock cannot be less than .003 inch.

SEC. 10. PHYSICAL ASPECTS AND REQUIREMENTS: PRINTING

.01 *Printing Medium*. The private printing of these substitute forms must be by conventional printing processes, photocopying, computer-graphics or similar reproduction processes.

.02 *Legibility*. Forms must have a high standard of legibility, both as to printing and reproduction and as to fill-in matter. The Service reserves the right to reject those with poor legibility.

.03 *Type Font*. Almost all federal tax forms are printed using "News Gothic" as the basic type font. We request that you use this type font when composing substitute forms.

.04 *Image Size*. The image size of printed material should be as close as possible to that of the official form. You may omit any text that is solely instructional.

.05 *Title Area Changes*. To allow a larger top margin for marginal printing and more lines per page (see Sec. 11 below), the title line(s) for all forms may be photographically reduced by 40 percent or reset as one line of type. When reset as one line, the type size may be no smaller than 14-point. You may omit "Department of Treasury, Internal Revenue Service" and all references to instructions in the form's title area.

.06 *Remove Government Printing Office Symbol.* When privately printing a tax form, the Government Printing Office symbol and/or jacket number must be removed. In the same place, using the same type size, print the Employer Identifying Number (EIN) or the Social Security Number (SSN) of the printer.

.07 *Printing On One Side of Paper.* While it is preferred that both sides of the paper be used for substitute and reproduced forms, resulting in the same page arrangement as that of the official form, the Service will not object if only one side of the paper is used.

.08 *Photocopy Equipment.* The Service does not undertake to approve or disapprove the specific equipment or process used in reproducing official forms, but requires only that the reproduced forms satisfy the conditions stated in revenue procedures.

.09 *Reproductions.* Reproductions of official forms and substitute forms which do not meet the requirements of this revenue procedure may not be filed instead of the official forms.

.10 *Removal of Instructions.* You may remove all references to instructions. No prior approval is needed.

SEC. 11. PHYSICAL ASPECTS AND REQUIREMENTS: MARGINS

.01 *Margin Size.* The format of the tax form when printed on the page must have margins on all sides at least as large as the margins on the official form. This allows room for Service employees to make the necessary entries on the form during processing.

.02 *Marginal Printing.*

1 *Non-Tax Material Allowed in Limited Areas.*

(a) On any 8- or 8½-inch-wide Service or substitute form, you may print your logo, company or firm name, identifying and collation symbols, etc., in the *left half of the top margin.*

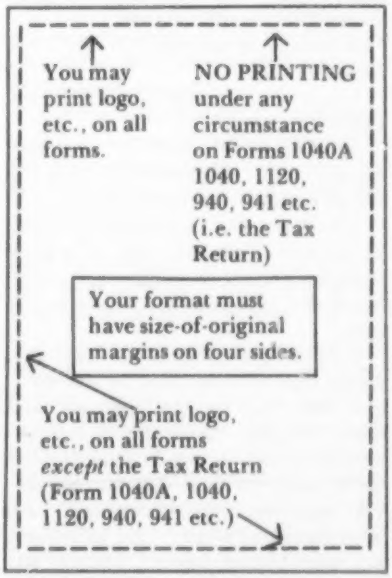
(b) With the exception of the actual tax return forms (i.e., Forms 1040, 1040A, 1120, 940, 941, etc.), you may also print in the *left vertical margin* and in the *left half of the bottom margin.*

(c) Printing is never allowed in the *right half of the top margin* of the tax return form (i.e., Forms 1040, 1040A, 1120, 940, 941, etc.). The Service uses this area to imprint a File Location Number for each return.

2 *Prior Approval Not Required.* Prior approval is not required for the marginal printing allowed in 1 above when used with the (unchanged) exhibits in this revenue procedure or when printed on an official form, on a photocopy of an official form, or on an (unchanged) reproduction proof.

3 *Prior Approval Required.* The marginal printing allowance in 1 above is also the guide for the preparation of acceptable substitute forms. There is no exception to the requirement that no printing is allowed in the *right half of the top margin* of the tax return form.

4 *Marginal Printing Areas Outlined*



You may print logo, etc., on all forms.

NO PRINTING under any circumstance on Forms 1040A 1040, 1120, 940, 941 etc. (i.e. the Tax Return)

Your format must have size-of-original margins on four sides.

You may print logo, etc., on all forms *except* the Tax Return (Form 1040A, 1040, 1120, 940, 941 etc.)

SEC. 12. APPROVED SUBSTITUTE FORMATS FOR SCHEDULES A AND B (FORM 1040)

.01 *Exhibits of Approved Formats.* Two sets of exhibits (Exhibits A-1 & B-1 and A-2 & B-2) are at the end of this revenue procedure. They are acceptable substitutes for the official forms. They are intended to be used in place of the official forms and may be used without prior approval. Both sets are usable for manual entry or computer preparation. Vertical spacing is six (6) lines to the inch. You may also refer to them as examples of how the guidelines in this revenue procedure may be used in some specific cases. Please note that the Service does NOT supply reproduction proofs for these exhibits.

.02 *Printing or Duplication of Exhibits A-1 & A-2 and B-1 & B-2.* You may (1) print these exhibits, or (2) duplicate them photographically or by using photo-reproduction techniques, PROVIDING YOUR PRINTED OR REPRODUCED IMAGES ARE EXACTLY LIKE THE ONES IN THE EXHIBITS. WITH THE EXCEPTION NOTED BELOW, NOTHING CAN BE CHANGED.

.03 *EXCEPTION.* In Exhibits A-1 and A-2, you may change the areas containing the circled numbers 1 through 9, as follows: (1) the areas inside the perimeter of the boxes containing the dash-leaders (- - -) and designated by the circled numbers may be used to print any particular deduction item associated with the corresponding deduction category, (2) the dash-leaders may be removed (BUT YOU MAY NOT CHANGE THE AMOUNT COLUMN BOX SIZE OR POSITION), and (3) the circled numbers should be removed.

.04 *Exhibits A-1 and A-2.*

1 *Exhibit A-1.* This substitute Schedule A format may be used as a single sheet or as one of the copies of a snap-set. It is designed to be used in place of the official Schedule A (Form 1040).

2 *Exhibit A-2.* This substitute Schedule A format may be used as a single sheet when both federal and state tax information is placed on the same form.

3 *No State Tax Information.* NO STATE TAX INFORMATION CAN APPEAR ON THESE FORMS WHEN FILED WITH THE FORM 1040. THE STATE COLUMN MAY BE PRESENT BUT THE *STATE TAX INFORMATION MUST NOT BE VISIBLE* WHEN FILED WITH THE SERVICE. We prefer that the entire state column be *COMPLETELY BLOCKED OUT.*

.05 *BLOCK OUT METHODS.* A suggested method to block out the state tax information is: (1) place the substitute form in a clear plastic folder, (2) on the folder, place a strip of opaque material the exact width and length of the column you wish to block out, then (3) photocopy the substitute form while still in the folder. The result will be a form with only the federal tax information visible. Another method is to take a black marking pen and, using either vertical or horizontal strokes, cross out the state figures. Carbon-interleaved sets may be used where the amounts entered in the state column are filled in with black carbon overprint. This copy may be filed with the return.

.06 *Exhibits B-1 and B-2*. These exhibits correspond to Exhibits A-1 and A-2, and the provisions in .05.1 and 2 above apply. Both of these exhibits are acceptable for use in place of the official Schedule B (Form 1040).

.07 *Exhibits A-1 and B-1 or A-2 and B-2*. These exhibits may be used as sets when the return calls for both Schedules A and B.

.08 *Please Note*. Exhibits of Schedules A and B in Rev. Proc. 80-47, 1980-2 C.B. 782, (for tax year 1980 substitute forms) inadvertently omitted vertical dollar and cents separators (e.g. a line) in the amount columns. Such lines (or separaters, are required when the form is manually prepared (see Sec. 8.05). Exceptions require prior approval.

SEC. 13. SPECIFICATIONS FOR FILING A SUBSTITUTE SCHEDULE K-1

Prior approval is NOT required for a substitute Schedule K-1 that accompanies Form 1065 (for partnership), a Form 1120-S (for small business corporation), or a Form 1041 (for fiduciary) when the substitute Schedule K-1 meets ALL of the following requirements.

.01 The substitute Schedule K-1 must contain only the line items required for use by the taxpayer.

.02 The line items must be in the same order and arrangement as those in the official form.

.03 The line items must be numbered, titled, and/or captioned exactly as shown on the official form.

.04 Each taxpayer's information must be on a separate piece of paper.

SEC. 14. REQUIRED PREPARATION OF FORMS

.01 *Completely Fill In Lines*. You must completely fill in all the numbered or reference lines on official forms (NOT JUST THE TOTALS, BUT ALL THE ITEMS THAT MAKE UP THE TOTALS AS WELL before attaching any supporting statement (see exceptions in Sec. 15).

.02 *Processing of Forms*. The Service processes the return based on information entered on the official forms or approved substitutes. References are made to attachments ONLY as required by law and as processing requirements direct. When you fail to complete all the pertinent lines on the official forms, Internal Revenue Service Tax Examiners have to locate the information on your attachment and write it on the proper line of the official form. This unfortunate process causes delays in processing the return and increases the potential for errors both in transcription and in interpretation.

.03 *Notification of Preparers*. THE SERVICE IS CONTINUING A NATIONWIDE PROGRAM TO NOTIFY PREPARERS WHO FAIL TO MEET THE REQUIREMENT TO COMPLETELY FILL IN LINES.

SEC. 15. EXCEPTIONS TO LINE COMPLETION REQUIREMENTS

.01 *Lines Captioned "Other" (All Forms)*. It is not necessary to fill in every numbered or referenced line of tax forms when the line caption calls for "Other," i.e., "Other (itemize)," "Other (specify)," "Other (attach schedule)," etc. Examples of this exception are lines 6d, 15, 19 and 31 for Schedule A (Form 1040). When this occurs, you may use a supporting statement and enter only the total amount of these "Other" items on the line of the official form. However, we prefer that you use the space on the official form when it is adequate.

.02 *Schedule A (Form 1040)*. All numbered and lettered lines must be filled in, if applicable. Supporting statements may be used to give the details of the totals entered on such lines but may not be used as a substitute for a collection of lines. For example, the detailed information for "Taxes" may not be shown on a supporting statement (supplemental schedule) and only line 16 filled in; but the details of "State and local income taxes" may be shown on a supporting statement and the total of such taxes entered on line 11. Also, lines 33 through 38 need not be filled in (they may be omitted) but the total of itemized deductions must be entered on line 39.

.03 *Schedule B (Form 1040)*. Lines 1c and 3 need not be filled in on the form. A supporting statement may be used for the details of interest and dividend income and the appropriate totals of such income entered on lines 1b, 1d and 4 unless nominee distribution or accrued interest criteria apply. (See the tax package instructions concerning interest.)

.04 *Schedule C (Form 1040)*. All lines on page 1 must be filled in when applicable except the line where "Other expenses-specify" is listed. (See instruction in .01 above.) All information for Schedule C-1 must be entered. Schedule C-2 and C-3 information may be entered on a supporting statement.

.05 *Schedule E (Form 1040)*.

1 When there are entries on page 1 for Part I, the following requirements must be met: (1) in Part I, Lines 1 and 2 the questions must be answered and tax information must be entered on the lines provided.

2 Supporting statements may be used for the details of rental and royalty and expenses. The appropriate totals must be carried and entered in the total column for lines 3, 17, 18, and 21 through 25.

3 Part II (Page 2)—The "at risk" questions must be answered. The income and loss from various partnerships, Estates or Trusts and small business corporations also may be detailed on a supporting statement, but the appropriate total income and total loss must be entered on lines 26 through 38 when applicable.

.06 *Form 4562* This form need not always be used to report depreciation. Instead you may use a supporting statement so long as it contains the same information as called for on the Form 4562.

.07 *Schedule F (Form 1040)*. If the cash method is used, only page one is needed. Otherwise both pages one and two must be entirely printed.

SEC. 16. SUPPORTING STATEMENTS

.01 *Use of Supporting Statements*. SUPPORTING STATEMENTS ARE TO BE USED TO SUPPORT LINE ENTRIES ON THE OFFICIAL FORM. Unless specifically authorized by this revenue procedure (see Sec. 15), THEY MUST NOT BE USED TO AVOID COMPLETING REQUIRED LINES ON THE OFFICIAL FORM.

.02 *Requirements for Supporting Statements.* Supporting statements must: (1) provide details and explain entries made on the official form, (2) furnish all required information in the same sequence as called for on the official form, and (3) furnish any additional information in the order of appearance on the form to which it refers.

.03 *Cross-Reference.* Each supporting statement must be referenced to the form it supports, and the entry on the form must be cross-referenced to the supporting statement. For example, put "Statement X" on the top of the supporting statement that contains the identified line number and the supporting information, and put "See Statement X" on the line of the form that references the statement.

.04 *Extent of Use.* You may attach supporting statements to explain or support any line item on an official or approved substitute form.

.05 *Assemblage.* For filing purposes, supporting statements are not attached directly to their related forms. Rather, all supporting statements are assembled in the same sequence as the forms they support; they are then placed after the lettered and numbered forms. (See Sec. 8.09.)

.06 *Multiple Supporting Statements.* Supporting statements for each numbered or lettered tax form may be on one page or may be on multiple pages. But each numbered or lettered form must have a separate page for its supporting statement(s). Each page should be the size of the form it supports, or it may be 8" x 11" or 8½" x 11".

.07 *Not Reviewed for Approval.* The Service does not give its approval for specific supporting statements. The taxpayer, or the tax practitioner for the taxpayer, must meet the needs as they arise, using the guidelines in this revenue procedure.

SEC. 17. SPECIFICATIONS FOR FILING SUBSTITUTE FORMS

.01 *Filing Substitute Forms.* Follow the same instructions as for filing official forms. These instructions are in the taxpayer's tax package.

.02 *Combination of Manually Prepared and Computer-Prepared/Generated Forms.* For filing purposes, the Service will accept substitute tax forms that contain a combination of computer-prepared/generated and manually filled in information.

.03 *Taxpayer and Preparer Signatures.* All taxpayer signatures on forms to be filed with the Service must be original signatures, affixed subsequent to the reproduction process. However, the income tax preparer can satisfy the manual signature requirement by signing a completed income tax return form, making a photocopy of the return form, and having the taxpayer sign and file the photocopy. (See Rev. Rul. 78-370, 1978-2 C.B. 336.)

.04 *Use Preaddressed Label.* When filing substitute or reproduced forms, use the preaddressed label included in the tax package the Service sent to the taxpayer. Use of the label avoids larger processing costs because it reduces the potential for error—the kind of error which can delay the receipt of refund and information needed by the taxpayer. No other label may be used.

.05 *Use Internal Revenue Service Envelope.* When filing substitute or reproduced forms, use the envelope enclosed with the taxpayer's tax package. This envelope is coded for sorting into several categories. Use of the coded envelope can help speed up the processing and reduce processing costs. Do not use the Service-provided tax package envelope for other correspondence with the Service, as its misuse can delay the correspondence.

.06 *Voluntarily Submitted Information.* Additional information required or voluntarily submitted should be on the same size paper as the official form and attached to the return following the supporting statements. (See Sec. 8.09.)

SEC. 18. GUIDANCE FROM OTHER REVENUE PROCEDURES

.01 Rev. Proc. 82-4 (Order as Publication 1168), page 22 this Bulletin, gives guidance for the substitute tax forms covered by this revenue procedure when these substitute tax form are computer-prepared or computer-generated.

.02 Guidance for the substitute tax forms not covered in this revenue procedure and the revenue procedures which govern their use are as follows:

Form 1040-ES—Rev. Proc. 79-56, 1979-2 C.B. 539, not reprinted for distribution
Form 1042S – Rev. Proc. 81-28, 1981-2 C.B. 549], Order as Publication 1161
Form W-2 series—Rev. Proc. 81-15, 1981-1 C.B. 670, Order as Publication 1141
Forms 1087 and 1099 series—Rev. Proc. 79-17, 1979-1 C.B. 516, Order as Publication 1091

SEC. 19. ORDERING REVENUE PROCEDURES

.01 If you receive Package X, Informational Copies of Federal Tax Forms, you may use the Form 2333P, Order Blank for Revenue Procedures, contained therein to order the following revenue procedures:

Pub. 1091, the revenue procedure on magnetic tape reporting for information returns (Forms 1087 and 1099).
Pub. 1141, the revenue procedure on specifications for private printing of Forms W-2, W-2P, and W-3.
Pub. 1149, the revenue procedure on magnetic tape reporting for Windfall Profit Tax (Form 6248).
Pub. 1161, the revenue procedure on reprinted paper substitutes for Form 1042S.
Pub. 1162, the revenue procedure on group exemption procedures.
Pub. 1167, the revenue procedure on reproduction requirements and substitute (printed) tax return forms and schedules.
Pub. 1168, the revenue procedure on computer-prepared and computer-generated substitute forms and schedules.

.02 The above listed revenue procedures may be obtained also by writing to: Internal Revenue Service, Revenue Procedure, P.O. Box 27322, Richmond, VA 23261. Be sure to order using the publication number.

.03 Rev. Proc. 79-56 (Form 1040-ES) is not reprinted for distribution.

SEC. 20. ORDERING REPRODUCTION PROOFS

.01 The Service provides camera-ready, reproduction-quality proof copies of many of its printed tax forms for public use. These reproduction proofs can only be ordered by using Form 6747, Order for Reproduction

Proofs. Form 6747 can be obtained in two ways: (1) by written request to Internal Revenue Service, RM:FM:P, Attention: Reproduction Proof Corodinator, Room 1528, 1111 Constitution Ave., N.W. Washington, D.C. 20224, or (2) by telephone request (at your expense) to the Reproduction Proof Coordinator at (202) 566-2473.

.02 Basic specifications, such as margin, pagination, etc., will be printed in the margins of the reproduction proofs and must be removed before printing. The official reproduction proof margins across the top, bottom, and sides must be maintained on all reproductions and substitute forms.

.03 A charge of $1.00 per page will be made for each reproduction proof regardless of page size. After an order has been filled, invoices will be mailed to the requestor.

SEC. 21. AGREEMENT

Any person or company who uses substitute forms and makes all or part of the changes specified in this revenue procedure, agrees to the following stipulation: The Service presumes the changes are made in accordance with these procedures and, as such, will be noninterruptive to the processing of the tax return. Should any of the changes prove to be not exactly as described, and as a result become disruptive to the Service during processing of the tax return, the person or company agrees to accept the determination of the Service as to whether or not the form may continue to be used during the filing season, and also agrees to work with the Service in correcting noted deficiencies. Notification of deficiencies may be made by letter, phone call, or both.

SEC. 22. EFFECT ON OTHER DOCUMENTS

This revenue procedure supersedes Rev. Proc. 80-47, 1980-2 C.B. 782.

SEC. 23. EFFECTIVE DATE

This revenue procedure is effective immediately.

EXHIBIT A - 1 (PREFERRED FORMAT)

(Form 1040)

Department of the Treasury
Internal Revenue Service

Substitute Schedule A
Itemized Deductions

OMB No. 1545-0074

1981
07

Name(s) as shown on Form 1040

Your social security number

Medical and Dental Expenses

Federal

1 ½ insurance premiums . . . .
2 Medicine and drugs . . . .
3 Enter 1% of Form 1040, line 31
4 Subtract line 3 from line 2 . . . .
5 Balance of insurance premiums . . . .

Doctors, dentists, nurses, etc. ....

①

6a Total doctors, dentists, nurses, etc. . . . . . .

Hospitals ....

②

6b Total hospitals . . . .

Transportation ....

③

6c Total Transportation . . . .

Other medical and dental expenses (itemize)—

④

6d Total other medical and dental expenses . . . .
7 Total (add lines 4 through 6d) . . . .
8 Enter 3% of Form 1040, line 31 . . . .
9 Subtract line 8 from line 7 . . . .
10 Total medical and dental . . . .

Taxes

11 State $........ Local $ ....
12 Real estate . . . .
13 a General sales (See Tables) . . . .
b General sales on motor vehicles . . . .
14 Personal property . . . .

Other (itemize) ▶ ....

⑤

15 Total other . . . .
16 Total taxes . . . . ▶

Interest Expense

17 Home mortgage . . . .
18 Credit and charge cards . . . .

Other (itemize) ▶ ....

⑥

19 Total other . . . .
20 Total interest expense . . . . ▶

Contributions

Federal

Cash contributions LESS than $3,000 to any one organization

⑦

21a Total . . . .

21b Cash contributions totaling $3,000 or MORE to any one organization

⑧

Other than cash

⑨

22 Total other than cash . . . .
23 Carryover from prior years . . . .
24 Total contributions . . . .

Casualty or Theft Loss(es)

25 Loss before reimbursement . . . .
26 Insurance reimbursement . . . .
27 Subtract line 26 from line 25 . . . .
28 Enter $100 or line 27 if smaller . . . .
29 Total casualty or theft loss(es) . . . . . . ▶

Miscellaneous Deductions

/A

30a Union dues . . . .
b Tax return preparation fee . . . .

Other (itemize) ▶ ....

⑩

31 Total other . . . .
32 Total miscellaneous deductions . . . . . . ▶
39 Total deductions . . . . ▶
40 If you checked Form 1040, Filing Status box:
2 or 5, enter $3,400 . . . .
1 or 4, enter $2,300 . . . .
3, enter $1,700 . . . .
41 Subtract line 40 from line 39 . . . . . . ▶

For Paperwork Reduction Act Notice, see Form 1040 Instructions.

Federal copy—File with Form 1040

EXHIBIT B - 1 (PREFERRED FORMAT)

(Form 1040)
Department of the Treasury
Internal Revenue Service

Substitute Schedule B
Interest and Dividend Income

OMB No. 1545-0074

1981

Name(s) as shown on Form 1040 (Do not enter name and social security number if shown on other side)

Your social security number

Part I Interest Income — **Federal**

1a Interest Income (List) — 1a

b Total interest income — 1b

c Interest from qualified all-saver certificates (List) — 1c

d Total of all-savers certificates — 1d

e Exclusion — 1e

f (Subtract line 1e from 1d) — 1f

2 Total interest income — 2

Part II Dividend Income

3 Gross dividends (List) — 3

4 Total of line 3 — 4

5 Capital gain distributions Enter here and on appropriate line(s) on Schedule D — 5

6 Nontaxable distributions — 6

7 Total (add lines 5 and 6) — 7

8 Total dividend income (Subtract line 7 from line 4) — 8

Part III

Foreign Accounts and Foreign Trusts

		Yes	No
9	At any time during the tax year, did you have an interest in or a signature or other authority over a bank account, securities account, or other financial account in a foreign country (see page 19 of instructions)?		
10	Were you the grantor of, or transferor to, a foreign trust which existed during the current tax year, whether or not you have any beneficial interest in it? If "Yes," you may have to file Forms 3520, 3520-A, or 926.		

Federal Copy B

EXHIBIT A - 2 (ACCEPTABLE FORMAT)

(Form 1040)
Department of the Treasury
Internal Revenue Service

Substitute Schedule A
Itemized Deductions

OMB No. 1545-0074
1981
07

Name(s) as shown on Form 1040

Your social security number

Medical and Dental Expenses

Federal

1 ½ Insurance premiums . . .
2 Medicine and drugs . . . .
3 Enter 1% of Form 1040, line 31
4 Subtract line 3 from line 2 . .
5 Balance of insurance premiums.

Doctors, dentists, nurses, etc. ▶ ....

①

6a Total doctors, dentists, etc. .

Hospitals ▶ ....

②

6b Total hospitals . . . . . .

Transportation ....

③

6c Total Transportation . . . .

Other medical and dental expenses (itemize)

④

6d Total other medical and dental expenses (itemize) . . . . .
7 Total (add lines 4 through 6d) .
8 Enter 3% of Form 1040, line 31
9 Subtract line 8 from line 7 . .
10 Total medical and dental . .

Taxes

11 State $.......... Local $..........
12 Real estate . . . .
13 a General sales (See Tables) .
b General sales on motor vehicles . . . .
14 Personal property . . . . . .

Other (itemize) ▶ ....

⑤

15 Total other . . . .
16 Total taxes . . . . ▶

Interest Expense

17 Home mortgage . . . . . .
18 Credit and charge cards . . .

Other (itemize) ▶ ....

⑥

18 Total other . . . .
20 Total interest expense . . ▶

Contributions

Federal

Cash contributions LESS than $3,000 to any one organization ....

⑦

21a Total . . . .
21b Cash contributions totaling $3,000 or MORE to any one organization ....

⑧

Other than cash

⑨

22 Total other than cash . . .
23 Carryover from prior years . .
24 Total contributions . . . .

Casualty or Theft Loss(es).

25 Loss before reimbursement . .
26 Insurance reimbursement . .
27 Subtract line 26 from line 25 .
28 Enter $100 or line 27 if smaller . . . .
29 Total casualty or loss(es) . .

Miscellaneous Deductions

30 a Union dues . . . . . .
b Tax return preparation fee .

Other (itemize) ▶ ....

⑩

31 Total other . . . . . .
32 Total miscellaneous deductions . . . . ▶
39 Total deductions . . . . ▶
40 If you checked Form 1040, Filing Status box:
2 or 5, enter $3,400 . . .
1 or 4, enter $2,300 . . .
3, enter $1,700 . . . .
41 Subtract line 40 from line 39 ▶

For Paperwork Reduction Act Notice, see Form 1040 Instructions.

Federal copy—File with Form 1040

EXHIBIT B - 2 (ACCEPTABLE FORMAT)

(Form 1040)
Department of the Treasury
Internal Revenue Service

Substitute Schedule B
Interest and Dividend Income

OMB No. 1545-0074

1981

Name(s) as shown on Form 1040 (Do not enter name and social security number if shown on other side) | Your social security number

		Federal
Part I **Interest Income**		
1a Interest income (List)	1a	
b Total interest income	1b	
c Interest from qualified all-savers certificates (List)	1c	
d Total of all-savers certificates	1d	
e Exclusion	1e	
f (Subtract line 1e from 1d)	1f	
2 Total interest income	2	
Part II **Dividend Income**		
3 Gross dividends (List)	3	
4 Total of line 3	4	
5 Capital gain distributions. Enter here and on appropriate line(s) on Schedule D	5	
6 Nontaxable distributions	6	
7 Total (add lines 5 and 6)	7	
8 Total dividend income (Subtract line 7 from line 4)	8	

Part III		Yes	No
Foreign Accounts and Foreign Trusts	9 At any time during the tax year, did you have an interest in or a signature or other authority over a bank account, securities account, or other financial account in a foreign country (see page 19 of instructions)?		
	10 Were you the grantor of, or transferor to, a foreign trust which existed during the current tax year, whether or not you have any beneficial intrest in it? If "Yes," you may have to file Forms 3520, 3520-A, or 926.		

For Paperwork Reduction Act Notice, see Form 1040 Instructions.

Federal Copy **B**

26 CFR 601.602: Forms and instructions.
(Also Part I, Sections 6001, 6011; 1.6001-1, 1.6011-1.)

Rev. Proc. 82-4

SECTION 1. PURPOSE

This revenue procedure states the Internal Revenue Service (the Service) requirements relating to acceptable computer-prepared substitute federal tax return forms (i.e., Forms 1040, 1040A, 1120, 940, 941, etc.) and computer-generated substitute forms to be attached thereto. It also gives direction for the proper completion of returns.

SEC. 2. SCOPE

This revenue procedure is the guide for preparing substitutes for most computer-prepared and computer-generated tax forms. This procedure does not include guidance for Form 1040-ES, Form 1042S, the Forms 1087 and 1099 series, and the Form W-2 series. (See Sec. 18 to obtain guidance for the excluded forms.)

SEC. 3. DEFINITIONS USED HERE

.01 *Substitute Form.* A tax form (or related schedule) that differs in any way from the official version and is intended to replace the entire form that is printed and distributed by the Service. This term also covers those approved substitute forms exhibited in this revenue procedure.

.02 *Printed Forms.* A form produced using conventional printing processes. Also, a printed form which has been reproduced by photocopying or similar processes.

.03 *Preprinted Pin-Fed Form.* A printed form that has marginal perforations for use with automated and high-speed printing equipment.

.04 *Computer-Prepared Substitute Form.* A printed form in which the taxpayer's name, address and tax entry information has been printed by a computer, computer-printer or other computer-type equipment, such as word-processing equipment.

.05 *Computer-Generated Substitute Form.* A form that is entirely prepared by the use of a computer printer so that all the line numbers, line captions, and the tax amount data entries are in the same typeface. No graphics appear on the form. (Most tax forms requiring signature may not be computer-generated. Among them are Forms 1040, 1040A, and 1120.)

.06 *Manually Prepared Form.* A printed form on which the taxpayer's name, address, and tax entry information is entered by an individual using a pen, pencil, typewriter, or other non-automated equipment.

.07 *Graphics.* Those parts of a printed tax form that are not tax amount entries or called-for information. Generally, these are line numbers, captions, instructions, special indicators, borders, rules, and strokes created by typesetting, photographics, photocomposition, etc.

.08 *Acceptable Reproduced Form.* A photocopy of an original form or of an unchanged reproduction proof supplied by the Service. (A reproduction is not a substitute form.)

.09 *Supporting Statement (Supplemental Schedule).* A document providing detailed information to support an entry for a line(s) on an official or approved substitute form and filed with (attached to) a tax return. (A supporting statement is not a tax form and does not take the place of an official form.)

SEC 4. MESSAGE TO TAX RETURN PREPARERS

.01 IF YOU PLAN TO CHANGE OR MODIFY *ANY* TAX FORMS, YOU MUST FOLLOW INTERNAL REVENUE PROCEDURES, AND, IN MANY CASES, YOU MUST GET OFFICIAL APPROVAL BEFORE USING SUBSTITUTE FORMS. THE SERVICE IS CONTINUING A NATIONWIDE PROGRAM TO IDENTIFY AND CONTACT TAX RETURN PREPARERS USING UNAPPROVED FORMS WHICH DO NOT CONFORM TO THIS REVENUE PROCEDURE AND IMPEDE PROCESSING OF THE RETURN.

.02 Additional information you may need regarding printed substitute forms is in Rev. Proc. 82-3, page 368, this Bulletin. You can get this revenue procedure by following instruction in Sec. 19.

SEC. 5. HIGHLIGHTS OF PERMITTED CHANGES AND REQUIREMENTS

.01 THINGS YOU CAN DO TO INTERNAL REVENUE SERVICE PRINTED TAX FORMS TO MAKE THEM SUITABLE FOR COMPUTER PREPARATION. PRIOR APPROVAL IS NOT REQUIRED.

1 You can PHOTOCOPY any tax form and use it instead of the official one.

2 You can REPRODUCE ANY CURRENT tax form as cut sheets, snap-sets, and marginally-punched, pin-fed forms, so long as you use an official Service version as the master copy. Official versions are supplied by the Service, such as those in the taxpayer's tax package, those in Package X, those printed in revenue procedures, and reproduction proofs sold by the Service.

3 You can ADJUST the graphics on specified areas of printed Forms 1040 and 1040A (and other forms) to allow for computer-printed or word processor fill-in. Only the areas listed in this revenue procedure may be adjusted without specific prior approval.

4 You can PRINT AND DUPLICATE the substitute "worksheet-type" versions of Schedules A and B of Form 1040 (shown as exhibits in Rev. Proc. 82-3). The Service will accept these substitute schedules instead of the official versions. These schedules serve different purposes. One allows the form to contain state tax information which is block-out before filing with the Service. The other allows the form to be used singly or as part of a snap-set.

.02 THINGS YOU *CANNOT DO* TO INTERNAL REVENUE SERVICE PRINTED TAX FORMS TO MAKE THEM SUITABLE FOR COMPUTER-PREPARATION.

1 You cannot, without prior Service approval, change any Internal Revenue Service tax forms or use your own (non-approved) version, unless specifically permitted by revenue procedure.

2 You cannot adjust any of the graphics on Forms 1040 and 1040A (except in those areas specified in revenue procedures) without prior approval from the Service.

3 Generally, you cannot use your own version of Schedule A (Form 1040) UNLESS YOU FIRST GET IT APPROVED. The Service wants only one Schedule A—either yours or ours; yours needs prior approval from the Service.

4 With some exceptions, you cannot omit filling out pertinent referenced (numbered or lettered) lines of the official Schedule A (and other tax

forms) when attaching a supporting statement. Exceptions to line completion requirements are listed in this revenue procedure.

5 You cannot use your own preprinted label on tax returns filed with the Service. The ONLY label permitted is the one provided the taxpayers in their tax packages. Otherwise, the taxpayer's name, address, and other identifying information must be entered on the return in the spaces provided.

.03 THINGS YOU CAN DO TO FILE COMPUTER-PREPARED/GENERATED FORMS. PRIOR APPROVAL IS NOT REQUIRED.

1 You can DUPLICATE the approved, computer-generated formats of SCHEDULES A, B, C, D, E, F, G, R, RP, SE (of this revenue procedure) and use them without prior approval.

2 You can FILL IN official Service supplied forms using computer or word-processing equipment. The Service forms are designed for a vertical spacing of six lines to the inch, with money amount columns wide enough to allow for the computer printing of ten characters.

3 You can CHANGE CERTAIN SPECIFIED AREAS on the Forms 1040 and 1040A (spelled out in the revenue procedures) to assist computer-printing requirements and to allow for more room on certain lines.

4 If you meet the requirements, standards, and qualifications of this revenue procedure, *you can*, without prior approval, computer-generate your own substitutes of the tax forms not exhibited here. (See Agreement in Sec. 21)

.04 THINGS YOU CANNOT DO TO INTERNAL REVENUE SERVICE FORMS

1 You cannot use computer graphics on any Service form without prior approval. (See Exception in Sec. 22).

2 You cannot computer-generate the TAX FORMS THEMSELVES (i.e., forms requiring signatures; for example, Forms 1040, 1040A, 1120, 940 and 941). These forms must be preprinted using conventional printing processes, photocopying or similar reproduction processes. The forms may be filled in by a computer, by a word processor, or the like, but the forms themselves must be printed like the Service versions are. First-time users of forms designed using computer graphics submitted must receive prior written approval. (See Exception in Sec. 22)

SEC. 6. APPROVAL

.01 *Basic Requirements.* Preparers who desire to file substitute tax forms and/or computer-generated tax forms must develop such substitutes using these guidelines. These substitutes, unless excepted by revenue procedure, must be approved by the Service before being filed.

.02 *Requests for Approval*

1 The Service cannot approve your substitute form until the official form has been published. Please propose your substitute after you have examined the official form.

2 You should know the revenue procedure relating to the official form before you attempt to alter the form to meet your needs. Any alteration of forms must be within the limits acceptable to the Service. It is possible that, from one filing period to another, a change in law or a change in internal need (processing, audit, compliance, etc.) may change the allowable limits for the alteration of the official form.

3 When specific approval of any substitute form is desired, a sample of the proposed substitute should be forwarded for consideration by letter to the Internal Revenue Service, Attention: Substitute Forms Program, TX:R:I, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

.03 *When to Send Proposed Substitutes.* Proposed substitutes should be sent to the address listed above, as much in advance of the filing period for the form as possible. This is to allow adequate time for analysis and response and to permit notice to our field offices that your substitute is acceptable. Quarterly filed forms, such as the Form 941, must be submitted by the first day of the last month of the quarter.

.04 *Accompanying Statement.* When the sample substitute is submitted, there should be an accompanying statement that lists the form number of each substitute requested and details those items that deviate from the official form in position, arrangement, appearance, line numbers, additions, deletions, etc. Included with each of the items should be a detailed reason or justification for the change and an approximation of the number of forms expected to be filed.

.05 *Approval/Non-Approval Letter.* The Service sends a formal letter of approval/non-approval. Approval letters may contain qualifications for use of the substitutes. Non-approval letters may specify the changes required for approval, but also require resubmission for approval.

.06 *Duration of Approval.*

1 Approvals are good for only one calendar year (January through December) or, in the case of corporation tax forms (with the exception noted below), for the remainder of the quarters of the calendar year.

2 PLEASE NOTE: In most cases each new filing season requires a new approval, even if the official form does not change. But see the exceptions in 3 and 4 below.

3 Exception: Quarterly tax forms in the 94X series (941, 942, etc.) are approved only for one quarter. Each new quarter requires a new approval.

4 Exception: Limited continued use of a change approved for a tax year 1980 form is allowed for the same form in tax year 1981. See .07 below for the limitations and for other requirements.

.07 *Limited Continued Use of an Approved Change.*

1 If you received written approval of a tax year *1980* substitute form governed by this revenue procedure and wish to continue to use the approved change in your tax year *1981* substitute form, you may revise the official form current in *1981* to include this change and, without additional written approval, use it as a tax year *1981* substitute form, PROVIDED you comply with the requirements in this revenue procedure. See exception in 2 below.

2 This means that if you received written approval for a specific change on a specific form last year, you may again make the same change on the same form this year. Thus, the change allowed in last year's approved substitute Schedule A, for example, can be continued in your new substitute for this year. The new substitute does not have to be sent to the Service, and written approval is not required. However, the new substitute must conform

to the official *1981* form in other respects: date, Office of Management and Budget (OMB) approval number, sequence number, arrangement, item caption, line number, line reference, sequence, etc. It must also comply with this revenue procedure—which may have eliminated, added to, or otherwise changed the guideline which affected the change approved last year. Additionally, you will be bound by the "Agreement" in Sec. 21.

EXCEPTION: Those written approvals which stated that the approved change or form would not be allowed in any other tax year.

3 This authorization for continued use of an approved change is limited to the continuation from a tax year *1980* substitute form to a tax year *1981* substitute form.

.08 *Requested Copies.* In our letter of approval, *you may* be requested to send to the Service eleven (11) copies of each approved form. When received, the copies will be used to notify Internal Revenue Service Centers that your substitute forms are approved. The requested forms should be assembled in sets. A set constitutes a return with the related schedules and forms in the same order as they will be filed, i.e., Form 1040, Schedules A, B, C, etc., Forms 2440, 2441, etc.

SEC. 7. OFFICE OF MANAGEMENT AND BUDGET (OMB) REQUIREMENTS FOR ALL SUBSTITUTE FORMS

.01 *New Legal Requirements of the Paperwork Reduction Act of 1980.* Public Law 96-511 requires that: (1) OMB approve Service tax forms, (2) each Service form contains (in the upper right corner) the OMB approval number and any expiration date, and (3) each form (or its instructions) state why the Service is collecting the information, how it will be used, and whether or not the information is required to be furnished.

.02 *Application to Substitute Forms.*

1 *Approval Number and Date Is Required.* All substitute forms must contain in the upper right corner (see Marginal Printing, Sec. 11.02.1(c)) the OMB number and any expiration date that is on the Service form.

2 *Format Required (3 Options).*

(a) OMB No. XXXX-XXXX (preferred)
or
OMB # XXXX-XXXX

(b) OMB No. XXXX-XXXX (preferred)
Expires XXXXXX (mmddyy)
or
OMB # XXXX-XXXX
Expires XXXXXX (mmddyy)

(c) OMB No. XXXX-XXXX Expires XXXXXX (mmddyy) (preferred)
or
OMB # XXXX-XXXX Expires XXXXXX

3 *Required Explanation to Users of Substitute Forms.* You must also inform the users of your substitute forms of the Service use and collection requirements stated in the instructions for the official Service form.

.03 *Obtaining OMB Number, Date, and Statement.* The OMB approval number, expiration date, and use and collection requirements may be obtained from the printed form (or its instructions), the reproduction proof (or instructions), or from the Service.

SEC. 8. GENERAL GUIDELINES

.01 *Official Form Is the Standard.* Because a substitute form is a variation from the official form, you should know the requirements of the official form for the year of use before you modify it to meet your needs. For the most frequently used tax forms, the quickest way to obtain an official form is to request reproduction proofs of these forms. (See Sec. 20.)

.02 *Design.* Each form must follow the design of the official form as to format, arrangement, item caption, line numbers, line references, and sequence.

.03 *State Tax Information Prohibited.* State tax information must not appear (be visible) on the federal tax return which is filed with the Internal Revenue Service Center, except where amounts are claimed on or required by the federal return, e.g., line 11, Schedule A (Form 1040). See Rev. Proc. 82-3, Sec. 12.06 Block Out Methods.)

.04 *Federal and State Columns.* When a form is designed with both federal and state columns, THE FEDERAL COLUMN MUST BE TO THE LEFT OF THE STATE COLUMN AND ADJACENT TO THE LINE CAPTION.

.05 *Vertical Alignment of Amount Fields.* When a form is to be computer-prepared, you may remove the vertical line in the amount field that separates dollars from cents. When a form is to be computer-generated, vertically align the amount entry fields where possible. You must also use one of the ten-character amount formats shown in Sec. 23.04.

.06 *Sequence Number.* Please note that certain forms have a recently added "sequence number" located just below the year designation in the upper right corner of the form. Form 1040 also has one opposite line 54 on the left side. The Service uses this number to indicate the order in which forms are processed when filed with a return. On computer-prepared forms it must be printed in no less than 12-point, boldface type and centered below the form's year designation. On computer-generated forms, place this sequence number following the year designation for the tax form and separate with an asterisk. (Example: 1981 * 07).

.07 *Forms with Sequence Number Required.* THE SEQUENCE NUMBER I REQUIRED ON THE FORMS LISTED BELOW. Please note that some of th numbers have been changed since las year.

Form 1040 Schedule/Form	*Sequenc Number*
1040	06 (Left of Line 5
A	0
C	0
D	1
E	1
F (Page 1)	1
(Page 2)	1
G	2
R and RP	2
SE	2
2119	
2440	
2441	
2555	
3468	
4136	
4625	
4726	

Form 1040 Schedule/Form	*Sequence Number*
4797	31
5329	32
5695	33
6251	34

.08 *Paid Preparer's Information and Signature Area.* On Forms 1040A, 1040, and 1120 etc., the "Paid Preparer's Use Only" area may not be rearranged or relocated. You may, however, add three extra lines to the paid preparer's address area without prior approval. This applies to other tax forms as well.

.09 *Assemblage of Forms.* When filing a return (i.e., Form 1040), we prefer that the return be arranged in this order: (1) the tax return, (2) lettered forms in alphabetical order (Schedule A, B, etc.), (3) the numbered forms shown in .07 above in sequence number order followed by all other numbered forms, (4) supporting statement in the same sequence as the forms they support, and (5) additional information required or voluntarily submitted. In this way, they are received in the order in which they must be processed. If you do not send them in this order, the Service has to disassemble them and place them in this order before processing is continued.

SEC. 9. PHYSICAL ASPECTS AND REQUIREMENTS: PAPER

.01 *Paper Content.* The paper must be:

1 Chemical wood writing paper that is equal to or better than the quality used for the official form;

2 at least 18 pound (17" x 22", 500 sheets) or

3 at least 45 pound (25" x 38", 500 sheets).

.02 *Paper Prohibited.* Carbon-bonded paper is prohibited from use for all substitute forms filed with the Service.

.03 *Paper with Chemical Transfer Properties—LIMITED USE.* Chemical transfer paper for all substitute forms may be used ONLY when the following specifications are met.

1 Each ply within the chemical transfer set of forms must be labeled.

2 Only the top ply (ply one and white in color), the one which contains chemical on the back only (coated back), may be filed with the Service. For example, a set containing three plies would be constructed as follows: ply one (coated back), "Federal Return, File with the Internal Revenue Section"; ply two (coated front and back), "Taxpayer's copy"; and ply three (coated front), "Preparer's copy."

3 The file designation, "Federal Return, File with the Internal Revenue Service," for ply one must be printed in the bottom right margin (just below the last line of the form) in 12-point, bold-face type. It is not mandatory, but recommended, that the file designation, "Federal Return, File with the Internal Revenue Service," be printed in a contrasting ink for visual emphasis.

.04 *Paper and Ink Color.* We prefer that the color of paper substantially duplicate that of the original form. You may use white paper. This means that your substitute must be printed in black ink and may be on white or on the color paper the Service form is printed on. An exception to this rule is that Forms 1040A and 1040 substitutes and reproductions may be in black ink without the colored screening. Any additional exception to this rule requires written approval from the Service.

.05 *Page Size.* Substitute or reproduced forms computer-prepared/generated substitutes may be the same size as the official form (8" x 11", in most cases) or they may be the standard commercial size 8½" x 11") exclusive of pin-feed holes. The thickness of the stock cannot be less than .003 inch.

.06 *Lined Paper.* Computer-generated substitute forms must be submitted on quality lined, machine paper. Lined, color-barred paper is also acceptable. Lined paper assists Service employees during processing of the returns by allowing speedy location of tax entries corresponding to line captions. The lines provide the basic means for eye-travel from one side of the form to the other.

.07 *Exception to Lined Paper Requirement.* If your printer has underlining capability, you do not have to use lined or color-barred paper so long as you underline every other text line on the form. The underlining must be a continuous line and extend from the left text margin to the right text margin and be the same length for all lines on the page.

SEC. 10. PHYSICAL ASPECTS AND REQUIREMENTS: PRINTING

.01 *Printing Medium.* The printing of computer-prepared substitutes must be by conventional printing processes, photocopying, computer-graphics, or similar reproduction processes.

.02 *Legibility.* All forms must have a high standard of legibility, both as to printing and reproduction and as to fill-in matter. The Service reserves the right to reject those with poor legibility.

.03 *Type Font.* Almost all federal tax forms are printed using "News Gothic" as the basic type font. We request that you use this type font when composing substitute computer-prepared forms.

.04 *Image Size.* The image size of printed computer-prepared forms should be as close as possible to that of the official form. You may omit any text on both computer-prepared and computer-generated forms that is solely instructional.

.05 *Title Area Changes.* To allow a larger top margin for marginal printing (see Sec. 11 below), the title line(s) for all computer-prepared forms (not including the form's year designation and sequence code, when present), may be photographically reduced by 40 percent or reset as one line of type. When reset as one line, the type size may be no smaller than 14-point. You may omit "Department of the Treasury Internal Revenue Service" and all reference to instructions in the form's title area.

.06 *Remove Government Printing Office Symbol.* When privately printing computer-prepared forms, the Government Printing Office symbol and/or jacket number must be removed. In the same place, using the same type size, print the Employer Identifying Number or the Social Security Number of the printer or designer.

.07 *Printing On One Side of Paper.* While it is preferred that both sides of the paper be used for computer-prepared forms, and reproduced forms, resulting in the same page arrangement as that of the official form or schedule, the Service will not object if only one side of the paper is used.

.08 *Photocopy Equipment.* The Service does not undertake to approve or disapprove the specific equipment or process used in reproducing official forms, but requires only that the reproduced forms satisfy the conditions stated in revenue procedures.

.09 *Reproductions.* Reproductions of official forms and substitute forms which do not meet the requirements of this revenue procedure may not be filed instead of the official forms.

SEC. 11. PHYSICAL ASPECTS AND REQUIREMENTS: MARGINS

.01 *Margin Size.*

1 The format of the tax form when printed on the page must have margins on all sides at least as large as the margins on the official form. This allows room for Service employees to make the necessary entries on the form during processing.

2 A one-half to one quarter inch margin must be maintained across the top, bottom, and both sides (exclusive of any pin-feed holes) of all computer-generated substitutes. The margin area is also used by Service employees to make necessary entries on the form during processing.

.02 *Marginal Printing.*

1 *Non-Tax Material Allowed in Limited Areas.*

(a) On any 8- or 8½-inch-wide Service or substitute form, you may print your logo, company or firm name, identifying and collation symbols, etc., in the *left half of the top margin.*

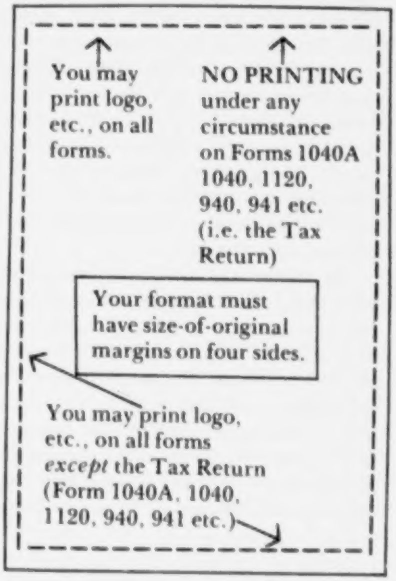
(b) With the exception of the actual tax return forms (i.e., Forms 1040, 1040A, 1120, 940, 941, etc.), you may also print in the *left vertical margin* and in the *left half of the bottom margin.*

(c) Printing is never allowed in the *right half of the top margin* of the tax return (i.e., Forms 1040, 1120, 940, 941, etc). (See Sec. 4 below)

2 *Prior Approval Not Required.* Prior approval is not required for the marginal printing allowed in 1 above when used with the (unchanged exhibits in this revenue procedure or when printed on an official form, on a photocopy of an official form or on an (unchanged) reproduction proof.

3 *Prior Approval Required.* The marginal printing allowance in 1 above is also the guide for the preparation of acceptable substitute forms. There is no exception to the requirement that no printing is allowed in the *right half of the top margin* of the tax return form.

4 *Marginal Printing Areas Outlined*


You may print logo, etc., on all forms.
NO PRINTING under any circumstance on Forms 1040A 1040, 1120, 940, 941 etc. (i.e. the Tax Return)
Your format must have size-of-original margins on four sides.
You may print logo, etc., on all forms *except* the Tax Return (Form 1040A, 1040, 1120, 940, 941 etc.)

SEC. 12. APPROVED SUBSTITUTE FORMATS FOR COMPUTER GENERATED FORM 1040 SCHEDULES

.01 *Exhibits of Approved Formats.* Acceptable computer-generated formats for the schedules usually attached to the Form 1040 are shown in the Exhibits section of this revenue procedure. The exhibits are for Schedule A, B, C, D, E, F, G, R, RP, and SE. There are two formats for Schedules A and B. All are acceptable substitutes for the official forms. They are intended to be used (without change) in place of the official forms and may be used without prior approval. All lines (including those not used for tax information must be printed. (Any change to text or format of an exhibit requires prior written approval.) Vertical spacing is six (6) lines to the inch. You may also refer to them as examples of how the guidelines in this revenue procedure may be used in specific cases.

.02 *Additional Approved Formats.* Acceptable formats for *printed* Form 1040 Schedule A and B are exhibited in Rev. Proc. 82-3, Substitute Forms; Private Design and Printing. They are usable for computer-preparation. The conditions in .01 above apply.

SEC. 13. SPECIFICATIONS FOR FILING SUBSTITUTE SCHEDULES K-1

Prior approval is NOT required for substitute Schedules K-1 that accompany 1065 (for partnership), 1120-S (for small business corporations), and 1041 (for fiduciaries) when the Schedules K-1 meet all of the following requirements.

.01 The Schedule K-1 must contain only the line items required for use by the taxpayer.

.02 The line items must be in the same order and arrangement as those in the official form.

.03 The line items must be numbered, titled, and/or captioned exactly as shown on the official form.

.04 Each taxpayer's information must be on a separate piece of paper.

SEC. 14. REQUIRED PREPARATION OF FORMS

.01 *Completely Fill-Out Lines.* You must completely fill out all the numbered or reference lines on computer-prepared or generated forms (not just the totals) BUT ALL THE ITEMS THAT MAKE UP THE TOTALS AS WELL before attaching any supporting statement (see Sec. 15 below for exceptions).

.02 *Internal Revenue Service Processing of Forms.* The Service processes the return based on information entered on the official forms or approved substitutes. References are made to attachments ONLY as required by law and as processing requirements direct. When you fail to complete all the pertinent lines on the official forms, Internal Revenue Service Tax Examiners have to locate the information on your attachment and write it on the proper line of the official form. This unfortunate process causes delays in processing the return and increases the potential for errors both in transcription and in interpretation.

.03 *Notification of Preparers.* THE SERVICE IS CONTINUING A NATIONWIDE PROGRAM TO NOTIFY PREPARERS

WHO FAIL TO MEET THE REQUIREMENT TO COMPLETELY FILL-OUT LINES.

SEC. 15. EXEPTIONS TO LINE COMPLETION REQUIREMENTS

.01 *Zero Entries.* Detailed information for any deduction or income category may be omitted from the printout if the category total to be reported is zero. However, the substitute form must show the total (zero when applicable) for each category. This means when no tax information is applicable, leave the line blank.

.02 *Lines Captioned "Other" (All Forms).* It is not necessary to fill in every numbered or referenced line of tax forms when the line caption calls for "Other," i.e., "Other (itemize)," "Other (specify)," "Other (attach schedule)," etc. Examples of this exception are lines 6d, 15, 19 and 31 for Schedule A Form 1040. When this occurs, you may use a supporting statement and enter only the total amount of these "Other" items on the line of the official form. However, we prefer that you use the space on the official form when it is adequate.

.03 *Schedule A (Form 1040).* All numbered and lettered lines must be filled in, if applicable. Supporting statements may be used to give the details of the totals entered on such lines. For example, the detailed information for "Taxes" may not be shown on a supporting statement (supplemental schedule) and only line 16 filled in. For example the details of "State and local income taxes" may be shown on a supporting statement and the total of such taxes entered on line 11. Also, lines 33 through 38 need not be filled in (they may be omitted) but the total of itemized deductions must be entered on line 39.

.04 *Schedule B (Form 1040).* Lines 1 and 3 need not be filled in on the form. A supporting statement may be used for the details of interest and dividend income and the appropriate totals of such income entered on lines 1b, 1d and 4 unless nominee distribution or accrued interest criteria apply. (See the tax package instructions concerning interest).

.05 *Schedule C Form (1040).* All lines on page 1 must be filled in when applicable except the lines where "Other expenses-specify" is listed. (See instruction in .02 above). All information for Schedule C-1 must be entered. Schedule C-2 and C-3 information may be entered on a supporting statement.

.06 *Schedule E (Form 1040).*

1 When there are entries on page 1 for Part I, the following requirements must be met: (1) in Part I, lines 1 and 2, the questions must be answered and tax information must be entered on the lines provided.

2 Supporting statements may be used for the details of rental and royalty income and expenses. The appropriate totals must be carried and entered in the total column for lines 3, 17, 18 and 21 through 25.

3 Part II (page 2) – The "at risk" questions must be answered. The income and loss from various partnerships, estates or trusts, and small business corporations also may be detailed on a supporting statement, but the appropriate total income and total loss must be entered on lines 26 through 38.

.06 *Form 4562* This form need not always be used to report depreciation. Instead you may use a supporting statement so long as it contains the same information as called for on the Form 4562.

.07 *Schedule F (Form 1040).* If the cash method is used, only page one is needed. Otherwise both pages one and two must be entirely printed.

SEC. 16. SUPPORTING STATEMENTS

.01 *Use of Supporting Statements.* SUPPORTING STATEMENTS ARE TO BE USED TO SUPPORT LINE ENTRIES ON THE OFFICIAL FORM. Unless specifically authorized by this revenue procedure (see Sec. 15), THEY MUST NOT BE USED TO AVOID COMPLETING REQUIRED LINES ON THE OFFICIAL FORM.

.02 *Requirements for Supporting Statements.* Supporting statements must: (1) provide details and explain entries made on the official form, (2) furnish all required information in the same sequence as called for on the official form, and (3) furnish any additional information in the order of appearance on the form to which it refers.

.03 *Cross-Reference.* Each supporting statement must be referenced to the form it supports, and the entry on the form must be cross-referenced to the supporting statement. For example, put "Statement X" on the top of the supporting statement that contains the identified line number and the supporting information, and put "See Statement X" on the line of the form that references the statement.

.04 *Extent of Use.* You may attach supporting statements to explain or support any line item on an official or approved substitute form.

.05 *Assemblage.* For filing purposes, supporting statements are not attached directly to their related forms. Rather, all supporting statements are assembled in the same sequence as the forms they support; they are then placed after the lettered and numbered forms (See Sec. 8.09).

.06 *Multiple Supporting Statements.* Supporting statements for each numbered or lettered tax form may be on one page or may be on multiple pages. But each numbered or lettered form must have a separate page for its supporting statement(s). Each page should be the size of the form it supports, or it may be 8" x 11" or 8½" x 11".

.07 *Not Approved.* The Service does not give its approval for specific supporting statements. The taxpayer or the tax practitioner for the taxpayer, must meet the needs as they arise, using the guidelines in this revenue procedure.

SEC. 17. SPECIFICATIONS FOR FILING SUBSTITUTE FORMS

.01 *Filing Substitute Forms.* Follow the same instructions as for filing official forms. These instructions are in the taxpayer's tax package.

.02 *Computer-Prepared Tax Forms.* For filing purposes the Service will accept computer-prepared tax forms (i.e., Forms 1040, 1040A, 1120, 940, 941, etc.) filled in by a computer or by word-processing equipment, but these forms MUST be pre-printed.

.03 *Computer-Generated Forms.* For filing purposes, the Service will accept computer-generated versions of forms that are attached to individual and business income tax returns, provided the substitutes and their manner of completion meet the guidelines prescribed herein.

READEX FICHE

.04 *Combination of Manually Prepared and Computer-Prepared/Generated Forms.* For filing purposes, the Service will accept substitute tax forms that contain a combination of computer-prepared/generated and manually filled in information.

.05 *Taxpayer and Preparer Signatures.* All taxpayer signatures on forms to be filed with the Service must be original signatures, affixed subsequent to the reproduction process. However, the income tax preparer can satisfy the manual signature requirement by signing a completed income tax return form, making a photocopy of the return form, and having the taxpayer sign and file the photocopy. (See Rev. Rul. 78-370, 1978-2 C.B. 336.)

.06 *Use Preaddressed Label.* When filing substitute or reproduced forms, use the preaddressed label included in the tax package the Service sent to the taxpayer. Use of the label avoids larger processing costs because it reduces the potential for error—the kind of error which can delay the receipt of refund and information needed by the taxpayer. No other label may be used.

.07 *Use Internal Revenue Service Envelope.* When filing substitute or reproduced forms, use the envelope enclosed with the taxpayer's tax package. This envelope is coded for sorting into several categories. Use of the coded envelope can help speed up the processing and reduce processing costs. Do not use the Service-provided, tax-package envelope for other correspondence with the Service, as its misuse can delay the correspondence.

.08 *Voluntarily Submitted Information.* Additional information required or voluntarily submitted should be on the same size paper as the official form and attached to the return following the supporting statements. (See Sec. 8.09.)

SEC. 18. GUIDANCE FROM OTHER REVENUE PROCEDURES

.01 Rev. Proc. 82-3, (Order as Publication 1167), page 368, this Bulletin, gives guidance for the substituted tax forms covered by this revenue procedure when these substitute tax forms are privately designed and printed.

.02 Guidance for the substitute tax forms not covered in this revenue procedure and the revenue procedures which govern their use, are as follows:

Form 1040-ES — Rev. Proc. 79-56, 1979-2, C.B. 539, not reprinted for distribution
Form 1042S — Rev. Proc. 81-28, 1981-2 C.B. 549, order as Publication 1161
Form W-2 series — Rev. Proc. 81-15, 1981-1 C.B. 670, order as Publication 1141
Form 1087 and 1099 series — Rev. Proc. 79-17, 1979-1 C.B. 516, order as Publication 1091

SEC. 19. ORDERING REVENUE PROCEDURES

.01 If you receive Package X, Informational Copies of Federal Tax Forms, you may use the Form 2333P, Order Blank for Revenue Procedures, contained therein to order the following revenue procedures:

Pub. 1091, the revenue procedure on magnetic tape reporting for information returns (Forms 1987 and 1099).
Pub. 1141, the revenue procedure on specification for private printing of Forms W-2, W-2P, and W-3.
Pub. 1149, the revenue procedure on magnetic tape reporting for Windfall Profit Tax (Form 6248).
Pub. 1161, the revenue procedure on reprinted paper substitutes for Form 1042S.
Pub. 1162, the revenue procedure on group exemption procedures.
Pub. 1167, the revenue procedure on reproduction requirements and substitute (printed) tax return forms and schedules.
Pub. 1168, the revenue procedure on computer-prepared and substitute computer-generated forms and schedules.

.02 The above listed revenue procedures may be obtained also by writing to: Internal Revenue Service, Revenue Procedure, P.O. Box 27322, Richmond, VA 23261. Be sure to order using Publication number.

.03 Rev. Proc. 79-56 (Form 1040-ES is not reprinted for distribution.)

SEC. 20. ORDERING REPRODUCTION PROOFS

.01 The Service provides for the public camera-ready, reproduction proofs of many of its printed tax forms. These reproduction proofs can only be ordered by using Form 6747, Order for Reproduction Proofs. Form 6747 can be obtained in two ways: (1) by written request to Internal Revenue Service, RM:FM:P, Attention: Reproduction Proof Coordinator, Room 1528, 1111 Constitution Ave., N.W., Washington, D.C. 20224, or (2) by telephone request (at your expense) to the Reproduction Proof Coordinator at (202) 566-2473.

.02 Basic specifications, such as margin, pagination, etc., will be printed in the margins of the reproduction proofs and must be removed before printing. The official reproduction proof margins across the top, bottom, and sides must be maintained on all reproductions and substitute forms.

.03 A charge of $1.00 per page will be made for each reproduction proof regardless of page size. After an order has been filled, invoices will be mailed to the requestor.

SEC. 21. AGREEMENT

Any person or company who uses substitute forms and makes all or part of the changes specified in this revenue procedure, agrees to the following stipulation: The Service presumes the changes are made in accordance with these procedures and, as such, will be noninterruptive to the processing of the tax return. Should any of the changes prove to be not exactly as described, and as a result become disruptive to the Service during processing of the tax return, the person or company agrees to accept the determination of the Service as to whether or not the form may continue to be used during the filing season, and also agrees to work with the Service in correcting noted deficiencies. Notification of deficiencies may be made by letter, phone call, or both.

SEC. 22. CONDITIONS—TAX FORMS 1040A, 1040, 1120, 940, 941, ETC.)

.01 PROHIBITED FORMS.

1 COMPUTER-GENERATED VERSIONS.

Computer-generated versions of the tax return (e.g. Form 1040, 1040A, 1120, 940, 941 etc.) which requires signature are not permitted. Only preprinted substitutes of these forms ar allowed.

2 COMPUTER-GENERATED GRAPHICS—FIRST TIME USERS

First-time users who design substitute forms using computer-graphics (e.g. laser printing) must receive prior approval before using them. Exception: Experienced users who have previously received written approval from the Service for tax forms do not need written approval before using their forms. However, users are bound by agreement in Sec. 21.

.02 FILL-IN INFORMATION.

The tax form itself (i.e., 1040, 1040A, 1120, 940, 941, etc.) may be filled in by a computer printer or other similar automated equipment, but the form itself must be created beforehand (i.e. preprinted) using conventional printing methods, photocopying computer-graphics (laser printing), or other similar reproduction processes.

.03 CHANGES PERMITTED TO THE FORMS 1040 & 1040A.

1 Certain changes (listed below) are permitted to the graphics of the form without prior approval, but these changes apply only to preprinted forms as described .02 above.

2 Changes not requiring prior approval are good only for the filing period January through December 1982.

3 Other changes not listed.

All changes not listed here require prior approval from the Service BEFORE the form may be filed with the Service.

SEC. 23. CHANGES PERMITTED TO GRAPHICS (FORMS 1040A AND 1040).

Changes Permitted to the Graphics on Both Form 1040 and 1040A and, Where Applicable, on Other Forms as Well for Use With computer-prepared (i.e. prnted forms *Only*.)

.01 *Adjustments*.

You may make minor vertical and horizontal spacing adjustments to allow for computer or word-processing printing. This includes widening the amount columns or tax entry areas so long as the adjustments do not exceed other provisions stated in revenue procedures. No prior approval is needed for these changes. However, the user of forms with such changes are bound by the "Agreement" in Sec. 8.

.02 *Name and Address Area*.

1 The horizontal rules and instructions within the name and address area may be removed and the entire area left blank; no line or instruction can remain in the area.

2 The heavy ruled border (when present) that outlines the name and address area must not be removed, relocated, expanded or contracted.

3 Required Format.

(a) When the name and address area is left blank, as provided in 1 above, the following format MUST be used when printing the taxpayer's name and address. Otherwise, unless the taxpayer's preprinted label is affixed over the information entered in this area, the lines must be filled-in as shown.

1st name line (35 characters maximum)

In-care-of name line (35 characters maximum)

Street address (35 characters maximum)

City, State (24 char. max.), one blank char., & zip (five char.)

(b) When there is no in-care-of name line, the name and address will consist of only three lines. Examples of the formats follow:

Example of name and address with NO in-care-of name line:

JOHN AND MARY JONES
1234 ANYWHERE ST. APT 111
ANYTOWN, DC. 12345

Example of name and address WITH in-care-of name line:

JOHN AND MARY JONES
C/O THOMAS A. JONES
4311 SOMEWHERE AVE.
SAMETOWN, DC 54321

(c) YOU MAY NOT USE YOUR OWN PREADDRESSED LABEL ON ANY INTERNAL REVENUE SERVICE FORM.

(d) The ONLY label that may be used is the OFFICIAL INTERNAL REVENUE SERVICE LABEL SUPPLIED to the taxpayer in his/her tax package. Please use the official Internal Revenue Service supplied label to help reduce errors.

(e) For identification purposes, you may computer print the taxpayer's name and address on the form and afterward affix the OFFICIAL INTERNAL REVENUE SERVICE SUPPLIED LABEL over the computer printed address. This applies whether or not the horizontal rules and the instructions have been removed from the address area.

.03 *Social Security Number (SSN) and Employer Identification Number (EIN) Area.*

1 The vertical lines separating the format arrangement of the SSN/EIN may be removed.

2 When the vertical lines are removed, the SSN and EIN formats must be 000-00-0000 or 00-0000000, respectively.

.04 *Cents Columns.*

1 You may remove the vertical rule that separates the dollars from the cents.

2 All entries in the amount column must have a decimal point following the whole dollar amounts whether or not the vertical line that separates the dollars from the cents is present.

3 You may omit printing the cents, but all amounts entered on the form must follow a consistent format. YOU ARE STRONGLY URGED TO ROUND OFF THE FIGURES TO WHOLE DOLLAR AMOUNTS.

4 When printing money amounts, you must use one of the following ten-character formats:

(a) 0,000,000.
(b) 000,000.00

5 When there is no entry for a line, leave the line blank.

.05 *"Paid Preparer's Use Only" Area*

1 On all forms, where present, the paid preparer's information area may NOT be rearranged or relocated.

2 You may add three lines and remove the horizontal rules in the preparer's address area.

SEC. 24. CHANGES PERMITTED TO FORM 1040A GRAPHICS

(for use with computer-printed forms only). No prior approval is needed for the following changes.

.01 *Line 4.*

The line caption may be compressed vertically to one line (to allow for same line entry for the name of the qualifying unmarried child) by using the following caption:

"Head of household; unmarried child's name . . . . . ." name field

.02 *Line 5c.*

To allow for a two-line field for printing dependent children's names, you may shorten the caption to:

"Dep. children" (names field)

(names field)

.03 *Line 5d.*

1 The vertical lines separating columns (1) through (5) may be removed.

2 The number of lines for listing "other dependents" may be expanded to a maximum of 5.

3 Column captions may be shortened to one line descriptions.

.04 *Line 9a (and 9b).*

These lines may be changed to allow larger amount entry fields by removing references to instructions.

.05 *Line 10.*

This line may be vertically compressed to one line by using the following caption:

"Adj Gross Income"

.06 *Other Lines.*

Any other line whose caption takes up two or more vertical lines may be compressed to one line by using contractions etc. and by removing instructional references.

.07 *Page 2 (Form 1040A).*

Lines for entries on 1a, c and 3 may be expanded to completely fill the remaining vertical page space.

Sec. 25. Other Changes Prohibited

NO OTHER CHANGES TO THE FORM 1040A GRAPHICS ARE ALLOWED WITHOUT PRIOR APPROVAL.

Sec. 26. Changes Permitted to the Form 1040 Graphics (For Use with Computer-Prepared Forms Only)

No prior approval is needed for the following changes:

.01 *Line 4.*

This line may be compressed horizontally (to allow for a larger entry area for the name of the qualifying unmarried child) by using the following caption:

"Head of household; unmarried child's name" (name field)

.02 *Line 6c.*

To allow for a two-line field for printing dependent children's names you may shorten the caption to:

"Dep. children" (names field)

(names field)

.03 *Line 6d.*

1 The vertical lines separating columns (1) through (5) may be removed. The captions may be shortened to allow a one-line caption for each column.

2 The number of lines for listing "other dependents" may be expanded to a maximum of 5 by compressing other noted areas and lines.

.04 *Other Lines.*

Any other line whose caption takes up two or more vertical lines may be compressed to one line by using contractions, etc., and by removing instructional references.

.05 *Line 20.*

1 This line may be expanded vertically to a maximum of 4 lines.

2 The amount entry box must remain a single entry and the cross hatched shading must extend down the numbered line box to the same number of lines you add.

.06 *Line 35.* You may change the line caption to read "Tax" and computer-print either the words "FROM TAX TABLES:" OR "FROM SCHEDULE/*FORM*" and computer-print the appropriate text.

.09 *Line 36.*

You may change the caption to read:

"Additional taxes from Form/Section" and computer-print only the form(s) or/and section number that apply.

Sec. 27. Other Changes Prohibited

NO OTHER CHANGES TO THE FORM 1040 GRAPHICS ARE PERMITTED WITHOUT PRIOR APPROVAL.

Sec. 28. Acceptable Formats of Computer-Generated Forms and Schedules

1 Exhibits of acceptable computer-generated formats for the schedules usually attached to the Form 1040 are shown in the Exhibits section of this revenue procedure.

2 Use of Acceptable Formats. If your computer-generated forms appear exactly like the exhibits, no prior authorization is needed.

3 CHANGES TO EXHIBITS NOT PERMITTED WITHOUT PRIOR APPROVAL. Any change to the text or format of any of the exhibits requires PRIOR WRITTEN APPROVAL.

Sec. 29. Computer-Generated Forms Not Shown as Exhibits in This Revenue Procedure

.01 Those desiring to computer-generate forms not shown here may do so, but they must design such forms themselves by following the manner and style of those in the Exhibits section of this publication and by taking care to observe other requirements and conditions stated here.

.02 Computer-generated forms so designed DO NOT require prior approval from the Service. However, the user of such forms is bound by the "Agreement" in Sec. 21 above.

.03 If you wish, you may submit any substitute form to the Service for approval consideration.

Sec. 30. Instructions for Preparing Computer-Generated Substitutes

.01 *Format Arrangement.*

The format of each substitute schedule must follow the format of the official schedule as to OMB number item caption, line reference, line numbers, sequence, form arrangement and format, etc. Basically try to make the form look like the official one, with readability being a primary factor. Use periods and/or other special characters to separate the various parts and sections of the form. With the exceptions in .02 below, all line numbers and items must be printed even though an amount is not entered on the line.

.02 *Line Numbers.*

1 When a line on an official form is designated by a number or a letter, that designation (reference code) must be used on a computer-generated substitute form.

2 The reference code must be printed to the left of the corresponding captioned line and also immediately preceding the data field even if there is no reference code immediately preceding the data field on the official form.

3 In addition, the reference code that is immediately before the data field must either be followed by a period or enclosed in parentheses. There also must be at least two blank spaces between the period or the right parentheses and the first character of the data field. (See example below.)

4 A decimal point (i.e., a period) must be used for each money amount regardless of whether the amount is reported in dollars and cents or in whole dollars, or whether or not the vertical line that separates the dollars from the cents is present. The decimal points must be vertically aligned when possible.

Example:

```
12   REAL ESTATE ............12. 495.00
13A  GENERAL SALES........13A.
13B  GEN SALES MOTOR VEH . 13B. 198.00
                 or
12   REAL ESTATE...........(12) 496.00
13A  GENERAL SALES .......(13A)
13b  GENERAL SALES MOTOR VEH
     ......................(13B) 198.00
```

.03 *Multiple Page Forms.* With the exceptions noted below, when printing multiple page forms the entire form with all its parts and pages must be printed. When printed on continuous forms, they must be burst and pin-feed holes removed before filing with the return.

.04 *Exception to Forms that must be entirely printed in whole or in part. Schedule F.* Depending on which accounting method is used, cash or accrual, the following will apply. If the cash accounting method is used only page one needs to be printed. Otherwise both page one and two must be entirely printed.

Sec. 31. Additional Instructions for All Forms

.01 Internal control numbers and identifying symbols of the computer preparer may be shown on the substitute, if the use of such manners or symbols is acceptable to the taxpayer and the taxpayer's representative. If shown, such information must not be printed in the top one-half inch clear area, from the center to the right edge, of any form or schedule requiring a signature. With the exception of the actual tax return form (i.e. Forms 1040, 1120, 940, 941, etc.), you may also print in the left vertical and bottom left margins. The bottom left margin you may use extends 3½ inches from the left edge of the form. (See Sec. 12 for more information on this subject.)

.02 Descriptions for captions, lines etc., appearing on the substitute forms may be limited to one print line by using abbreviations and contractions and by omitting articles, prepositions, etc. However, sufficient key words must be retained to permit ready identification of the caption, line or item.

1 Explanatory detail and/or intermediate calculations for derivation of fine line totals, may be included on the substitute. We prefer that such calculations be submitted in the form of a supporting statement. If intermediate calculations are included on the substitute, the lines on which they appear may not be numbered or lettered. Intermediate calculations may not be printed in the right column. This column is reserved for official numbered and lettered lines that correspond to the ones on the official form. If a supporting statement is submitted, intermediate calculations or subtotals may be formatted at the preparer's option.

2 Text prescribed for the official form, which is solely instructional in nature, e.g., "Attach this schedule to Form 1040," "See instructions," etc., may be omitted from the substitute form.

3 Information for more than one schedule may not be shown on the same printout page without prior approval from the Service. Except for computer-generated Schedules A and B (Form 1040), almost any form may be continued on two or more pages if necessary. When a form is continued on two or more pages, clearly identify at the bottom of each page, including page 1, that is continued, e.g., "page 1, Schedule C continued." It is strongly recommended that a substitute form not exceed the same number of pages used for the official form.

4 Identify all computer-prepared substitutes clearly; print the form designation one-half inch from the top margin and one and one-half inches from the left margin; print the title centered on the first line of print; and print the taxable year and, where applicable, the sequence number on the same line one-half to one inch from right margin. Include the taxpayer's name and SSN on all forms and attachments. Also print the OMB number and (when applicable) the forms expiration date.

5 The state tax column may be present, but the state tax information must NOT be visible on the copy filed with the Service. When a form is designed with both federal and state columns, THE FEDERAL COLUMN MUST BE TO THE LEFT OF THE STATE COLUMN AND ADJACENT TO THE LINE CAPTION.

6 Attach all schedules in alphabetical order and forms in numerical order followed by supporting statements. The sequence of information on supporting statements must be the same order as the items appear on the form(s) to which it is referenced. It would be helpful if you would voluntarily attach the schedules and forms to the return in ascending sequence number order, followed by other numbered forms and then supporting statements.

7 Attach all payments (check or money order, no cash) to the front of the tax return.

Sec. 32. Filing Substitute Forms With IRS

Follow the same instructions as for filing official forms. These instructions are in the taxpayer's tax package.

Sec. 33. Effect on Other Documents

This revenue procedure supersedes Rev. Proc. 80-48, 1980-2 C.B. 792.

EXHIBIT CG - A1 (SCHEDULE A - PREFERRED FORMAT)

```
SCHEDULE A (FORM 1040)         ITEMIZED DEDUCTIONS                 1981 * 07
                                                            OMB NO. 1545-0074
JOHN Q. & MARY J. TAXPAYER                                    SSN 000-00-0000
******************************************************************************
**** MEDICAL AND DENTAL EXPENSES ****  *     ****** CONTRIBUTIONS ******
                                       * 21A CASH.......... 21A.  00,000.00
1  1/2 INSURANCE PREM.   1.  00,000.00 *       LESS THAN $3000
                                       * 21B CASH.......... 21B.
2  MEDICINE & DRUGS .... 2.            *       MORE THAN $3000
3  1% OF LINE 31, 1040.. 3.            *    LIST DONEES & AMTS
4  LINE 2 LESS LINE 3... 4.            *  1ST
                                       *  2ND
5  BALANCE OF INS PREM.. 5.            *  3RD         OR SEE STATEMENT XX
                                       *  4TH
6  OTHER MEDICAL & DENT.               *  5TH
   (A) DOCTORS, DENT... 6A.            *  6TH
   (B) HOSPITALS ...... 6B.            * 22 OTHER THAN CASH. 22.
   (C) TRANSPORTATION   6C.            *  SEE STATEMENT XX
   (D) OTHER (ITEMIZE)
1ST................ 6D.                * 23 CARRY OVER...... 23.
2ND                                    * 24 TOTAL CONTRIB... 24.
3RD                                    *
4TH  OR SEE STATEMENT XX               * ***** CASUALTY, THEFT LOSS   ******
5TH                                    * 25 LOSS BEFORE INS. 25.
6TH                                    * 26 INSUR. REIMBURSE 26.
7TH                                    * 27 L 25 LESS L 26.. 27.
7  TOTAL (4 THRU 6d).... 7.            * 28 $100 OR L27..... 28.
8  3% OF LINE 31, 1040.. 8.            *
9  LINE 7 LESS LINE 8... 9.            * 29 TOTAL LOSS ..... 29.
                                       *
                                       * ******* MISC. DEDUCTIONS *********
                                       * 30A UNION DUES..... 30A.
                                       * 30B Prep. Fee       30B.
10 TOTAL ( LINES 1+9)  10.  00,000.00  * 31 OTHER (ITEMIZE). 31.
                                       *  1ST
****** TAXES ************************* *  2ND
11 ST & LOCAL INCOME... 11.            *  3RD
12 REAL ESTATE......... 12.            *  4TH
13A GENERAL SALES......13A.            *  5TH       OR SEE STATEMENT XX
13B GEN SALES Auto.    13B             *  6TH
14 PERSONAL PROPERTY... 14.            *  7TH
15 OTHER (ITEMIZE)      15.            *  8TH
   1ST ................                *  9TH
   2ND  OR SEE STATEMENT XX            *  10TH
   3RD                                 *  11TH
16 TOTAL TAXES ........ 16.            *  12TH
** INTEREST EXPENSE *****************  * 32  TOTAL MISC DED..32.
17  HOME MORTGAGE...... 17.            **************************************
18  CREDIT & CHG CARDS. 18.            *
19 OTHER (ITEMIZE)..... 19.            * 39 TOTAL DEDUCTIONS.39.
 1ST                                   *
 2ND                                   * 40 ZERO BRACKET AMT.40.
 3RD     OR SEE STATEMENT XX           *
                                       *
20 TOTAL INTEREST       20.            * 41 L 40 LESS L 39...41.
                                       *
```

EXHIBIT CG-A2 (SCHEDULE A - ACCEPTABLE FORMAT)

```
SCHEDULE A-1040                    ITEMIZED DEDUCTIONS                   1981 * 07
                                                         OMB NO. 1545-0074
JOHN W. & MARY J. TAXPAYER                                       SSN 000-00-0000
**************************************************************************************
***** MEDICAL AND DENTAL EXPENSES ************************************ FEDERAL
  1  ONE HALF MED INS PREM ......................................... 1. 000,000.00
  2  MEDICINE & DRUGS  ............................................. 2.
  3  1% L31 1040 ................................................... 3.
  4  L2 LESS L3  ................................................... 4.
  5  BAL INS PREMS ................................................. 5.
  6  OTHER MED & DENT EXP
   A DOCTORS, DENTISTS, ETC. ....................................... 6A.
   B HOSPITALS ..................................................... 6B.
   C TRANSPORTATION................................................. 6C.
   D OTHER (ITEMIZE) - SEE STATEMENT XX ............................ 6C.
  7  ADD LN 4 THRU LN 6D........................................... 7.
  8  3% L31 1040 .................................................. 8.
  9  L7 LESS L8 ................................................... 9.
 10  TOTAL MED L1 PLUS L9 ......................................... .10.

*****  TAXES  ******************************************************************
 11  ST & LOCAL INCOME ........................................... 11.
 12  REAL ESTATE ................................................. 12.
 13A GENL SALES .................................................. 13A.
 13B GEN SALES - MOTOR VEHICLES.................................. 13B.
 14  PERS PROP ................................................... 14.
 15  OTHER (ITEMIZE)- SEE STATEMENT XX ......................... . 15.
 16  TOTAL TAXES (ADD L11 THRU L15) .............................. 16.

*****  INTEREST EXPENSE  *******************************************************
 17  HOME MTG .....................................................17.
 18  CREDIT & CHG CARDS ...........................................18.
 19  OTHER (ITEMIZE) -SEE STATEMTMENT XX ..........................19.
 20  TOTAL INTEREST EXPENSE (ADD L17 THRU L19) ....................20.

*****  CONTRIBUTIONS  **********************************************************
 21A CASH LESS THAN $3000 TO ANY ONE ORGANIZATION               21A.
 21B CASH $3000+ TO ANY ONE ORGANIZATION (SEE STATEMENT XX)     21B.
 22  OTHER THAN CASH - SEE STATEMENT XX ........................ 22.
 23  CARRYOVER ................................................. 23.
 24  TOTAL CONTRIBUTIONS (ADD L21A THRU L23) ................... 24.
*****  CASUALTY OR THEFT LOSS     **********************************************
 25  LOSS BEFORE INSURANCE REIMBURSMENT.......................... 25.
 26  INSURANCE REIMBURSEMENT..................................... 26.
 27  L25 LESS L26 ............................................... 27.
 28  SMALLER OF $100 or L27 ..................................... 28.
 29  TOTAL CASUALTY OR THEFT LOSS (L27 LESS L28) ................ 29.
*****  MISCELLANEOUS DEDUCTIONS************************************************
 30A UNION DUES...................................................30A.
 30B TAX RETURN PREPARATION FEE...................................30B.
 31  OTHER MISC-SEE STATEMENT XX................................. 31.
 32  TOT MISC DED (L30 PLUS L31) ................................ 32.
*******************************************************************************
 39  TOTAL ITEM DEDUCTIONS - SUM OF L10,16,20,24,29,32 ...... 39.
 40  ZERO BRACKET AMOUNT..........................................40
 41  EXCESS ITEMIZED DEDUCTIONS (L39 LESS L40)....................41
```

EXHIBIT CG - B1 (SCHEDULE B - PREFERRED FORMAT)

```
SCHEDULE B (FORM 1040) DIVIDEND AND INTEREST INCOME                    1981
                                                             OMB NO. 1545-0074
JOHN Q. & MARY J. TAXPAYER                                     SSN 000-00-0000
******************************************************************************
PART I  INTEREST INCOME -                 *  PART II  DIVIDEND INCOME
                                          *
1A IF YOU RECEIVED MORE THAN $400 IN      *  3 GROSS DIVIDENDS (INCLUDING CAPITAL
   INTEREST, OR ANY ALL-SAVERS INTEREST*       GAIN DISTRIBUTIONS) AND OTHER
   COMPLETE PART I. &/OR III.             *    DISTRIBUTIONS ON STOCK.
                                          *
       NAME OF PAYER                      *
                                AMOUNT    *   NAME OF PAYER              AMOUNT
(1ST PAYER)                  00,000.00    *  (1ST PAYER)              00,000.00
(2ND PAYER)   OR SEE STATEMENT XX         *  (2ND PAYER)   OR SEE STATEMENT XX
(3RD PAYER)                               *  (3RD PAYER)
                                          *
1B TOTAL ............. 1B.                *    4  TOTAL OF LINE 3 . 4.
1C ALL SAVERS ........ 1C.                *    5  CAPITAL GAIN
1ST                                       *
2ND                                       *
3RD                                       *
1D TOTAL ............ 1D.                 *       DISTRIBUTIONS ..   .5.
IE EXCLUSION ........ 1E.                 *
1F LINE 1D MINUS 1E.. 1F.                 *    6  NONTAXABLE DIS.  6
                                          *
2  TOTAL INTEREST..... 2.                 *    7  TOTAL LN 5+LN 6  7
                                          *
                                          *    8  DIVIDENDS....... 8.   00,000.00
                                          *       BEFORE EXCLUSION
******************************************************************************
PART III

9. DID YOU HAVE ANY INTEREST,SIGNATURE AUTHORITY OVER A BANK,SECURITIES, OR
   FINANCIAL ACCOUNT IN A FOREIGN COUNTRY                                 (ANS)

10. WERE YOU GRANTOR, TRANSFEROR IN CURRENT TAX YEAR TO FOREIGN TRUST WHETHER
   OR NOT IT WAS TO YOUR BENEFIT.                                         (ANS)
```

EXHIBIT CG - B2 (SCHEDULE B - ACCEPTABLE FORMAT)

```
SCHEDULE B (FORM1040)   DIVIDEND AND INTEREST INCOME                   1981
                                                    OMB NO. 1545-0074
                                                              SSN 000-00-0000
JOHN Q. & MARY J. TAXPAYER
*************************************************************************
PART I  INTEREST INCOME-IF YOU RECEIVED MORE THAN $400 IN INTEREST,OR ANY
           ALL-SAVERS INTEREST, COMPLETE PARTS I & OR III.
                                                                    AMOUNT
                NAME OF PAYER

                                                                 00,000.00
(1ST PAYER)
(2ND PAYER)    OR SEE STATEMENT XX
(3RD PAYER)

1B  TOTAL INTEREST .......................................1B.
1C ALL-SAVERS INTEREST (LIST) ............................1C.
1ST
2ND
3RD
1D TOTAL ALL-SAVERS INTEREST .............................ID.
1E EXCLUSION .............................................1E.
1F LINE ID MINUS IE ......................................1F.

2  TOTAL INTEREST INCOME .................................2.   00,000.00
*************************************************************************
PART II  DIVIDEND INCOME

3  GROSS DIVIDENDS (INCLUDING CAPITAL GAIN DISTRIBUTIONS)

                                                                  AMOUNT
        NAME OF PAYER
*************************************************************************
                                                                00,000.00
(1ST PAYER)
(2ND PAYER)    OR SEE STATEMENT XX
(3RD PAYER)




4.  TOTAL ALL ITEMS FOR LINE 3 ............................. 4.
5.  CAPITAL GAIN............................................ 5.
6.  NONTAXABLE DISTRIBUTIONS................................ 6.
7.  TOTAL LINES 5 AND 6..................................... 7.
8.  DIVIDENDS BEFORE EXCLUSION  LN 4 LESS LN 7.............. 8.  00,000.00
*************************************************************************
PART III  FOREIGN ACCOUNTS & TRUSTS

9  AT ANY TIME DURING THE YEAR, DID YOU HAVE ANY INTEREST,        (ANS)
   SIGNATURE AUTHORITY OVER A BANK ACCOUNT,SECURITIES
   ACCOUNT OR OTHER FINANCIAL ACCOUNT IN A FOREIGN COUNTRY?

10 WERE YOU THE GRANTOR OF, OR TRANSFEROR TO, A FOREIGN TRUST    (ANS)
   DURING CURRNT TAX YEAR WHETHER OR NOT IT WAS TO YOUR BENEFIT?
```

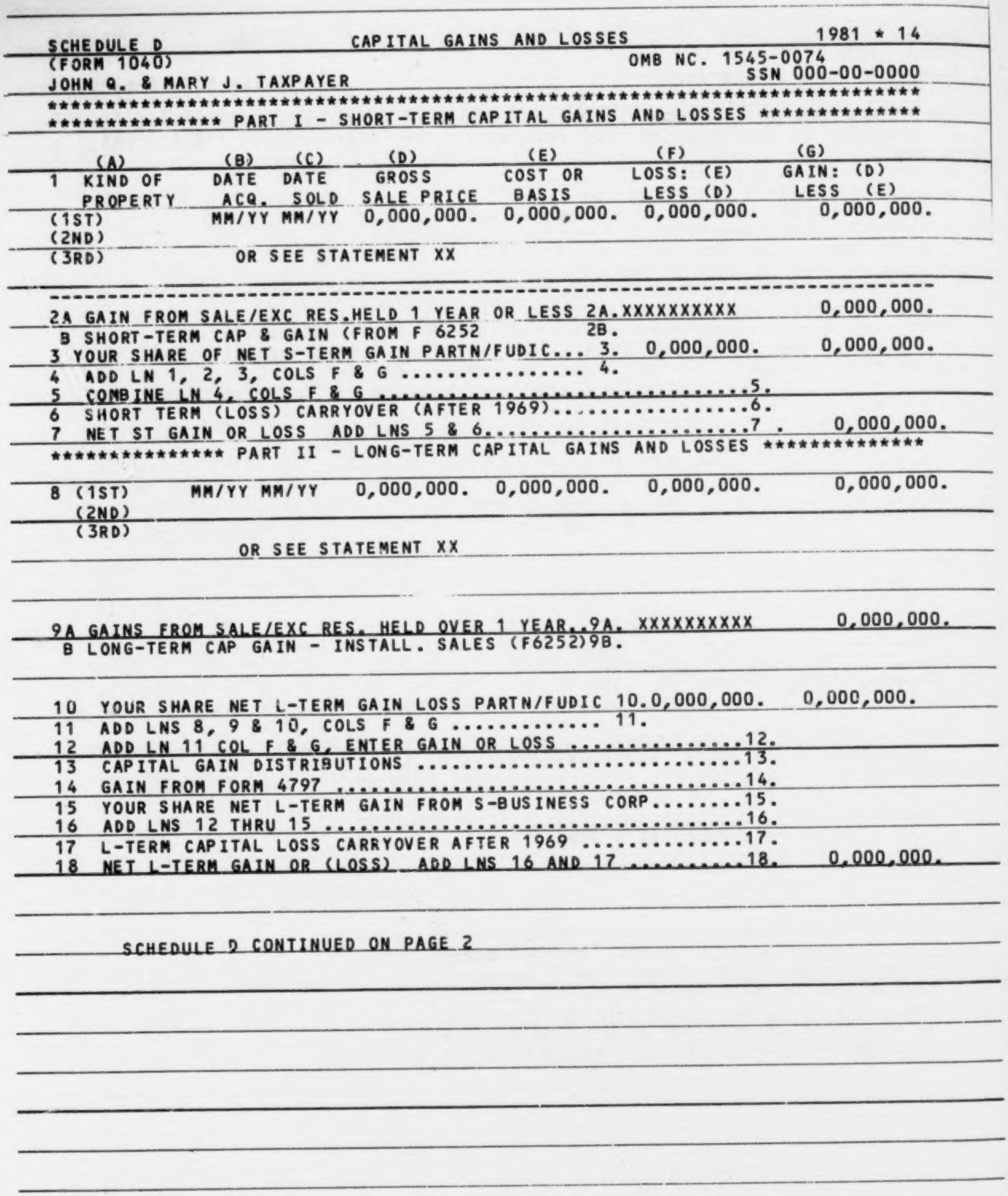
EXHIBIT CG - C (SCHEDULE C - PAGE 1)

```
SCHEDULE C      PROFIT (OR LOSS) FROM BUSINESS OR PROFESSION      1981 * 08
(FORM 1040)              (SOLE PROPRIETORSHIP)          OMB NO. 1545-0074

JOHN Q. & MARY J. TAXPAYER                                  SSN  000-00-0000
****************************************************************************
A MAIN BUSINESS ACTIVITY:                              PRODUCT:
B NAME:
C EMPLOYER ID NO.:  00-0000000
D BUSINESS ADDRESS:
  CITY STATE & ZIP:
E ACCOUNTING METH.:  (1)  XX CASH
F METHOD(S) USED TO VALUE CLOSING INVENTORY:
  (1) X COST
G WAS THERE ANY SUBSTANTIAL CHANGE IN THE METHOD OF VALUATION ?        (ANS)
H DID YOU DEDUCT EXPENSES FOR OFFICE IN HOME ?                         (ANS)
****************************************************************************
PART I-INCOME:
1 A GROSS RECEIPTS OR SALES .................................1A.  0,000,000.
  B RETURNS AND ALLOWANCES ..................................1B.
  C BALANCE (LINE 1A LESS LINE 1B) ..........................1C.
2 COSTS OF GOODS SOLD AND/OR OPERATIONS ..................... 2.
3 GROSS PROFIT (LINE 1C LESS LINE 2) ........................ 3.
4A WINDFALL PROFIT TAX CREDIT/REFUND FOR 81................ .4A.
4B OTHER INCOME  - SEE STATEMENT XX ........................4B.
5 TOTAL INCOME (ADD LINES 3, 4A & 4B......................... 5.  0,000,000.
****************************************************************************
PART II-DEDUCTIONS:
 6 ADVERTISING ........... 0,000,000. 29A WAGES .............     0,000,000.
 7 AMORTIZATION .........               B JOBS CREDIT .......
 8 BAD DEBTS .............              C WIN CREDIT  .......
 9 BANK CHARGES  .........              D TOTAL CREDITS .....
10 CAR/TRUCK EXPENSES ....              E 29A LESS 29D  .....
11 COMMISSIONS ...........            30 WINDFALL PROF TAX
                                      31 OTHER EXPENSES (LIST)
12 DEPLETION .............              A
13 DEPRECIATION...........              B
14 DUES AND PUBLICATIONS .              C
15 EMPLOYEE BENE PROGMS                 D
16 FREIGHT (NOT ON C-1)...              E
17 INSURANCE .............              F
18 INTEREST ON BUS.DEBT                 G
19 LAUNDRY AND CLEANING ..              H
20 LEGAL/PROF'L SERVICES                I
21 OFFICE & POSTAGE.......              J        OR SEE STATEMENT XX
22 PENSION/PROFIT SHARING.              K
23 RENT ON BUSINESS PROP.               L
24 REPAIRS................              M
25 SUPPLIES (NOT ON C-1.).              N
26 TAXES (NOT WINDFALL)...              O
27 TRAVEL & ENTERTAINMENT.              P
28 UTILITIES & PHONE......              Q
****************************************************************************
32 TOTAL DEDUCTIONS (ADD COLS. 6 THROUGH 31i) ............  32.
33 NET PROFIT (OR LOSS) (LINE 5 LESS LINE`33).............  33.  0,000,000.
34 IF LOSS, DO YOU HAVE AMTS IN THIS BUSINESS NOT AT RISK?  (ANS)

     SCHEDULE C CONTINUED ON PAGE 2
```

EXHIBIT CG - C (SCHEDULE C - PAGE 2)

```
SCHEDULE C (CON'T) PAGE 2                                1981
(FORM 1040)
JOHN Q. & MARY J. TAXPAYER                               SSN 123-45-6789

*****  SCHEDULE C-1   COST OF GOODS SOLD AND/OR OPERATIONS  ***************
1   INVENTORY AT BEGINNING OF YEAR (EXPLAIN IF NOT 1981).  1.      0,000,000.
2A  PURCHASES ......................................... 2A.
 B  COST OF ITEMS WITHDRAWN ........................... 2B.
 C  BALANCE (LINE 2A LESS LINE 2B) .................... 2C.
3   COST OF LABOR (DO NOT INCLUDE OWN SALARY) ........... 3.
4   MATERIALS AND SUPPLIES ............................ 4.
5   OTHER COSTS (SEE STATEMENT XX)..................... 5.
6   ADD LINES 1, 2C, AND 3 THROUGH 5 .................. 6.
7   INVENTORY AT END OF YEAR .......................... 7.
8   COST OF GOODS AND/OR OPERATIONS (LN 6 LESS LN 7) .... 8.
***************************************************************************
    SCHEDULE C-2 - DEPRECIATION ONLY FOR ASSETS IN SERVICE BEFORE 1-1-81.
DESCRIPTION OF PROP.      DATE   COST OR   DEPRECIA-   METHOD  LIFE   DEPRECIA-
                          ACQ.   BASIS     TION PRIOR          /RATE  TION 1981
       (A)                (B)    (C)        (D)         (E)    (F)     (G)
1  DEPRECIATION                                         XX            0,000,000.

                                                     TYPE OF METHOD MUST BE
                     OR SEE STATEMENT XX  --         HERE IN ORDER TO USE
                        OR FORM 4562                 STATEMENT OPTION

                                                ENTER TOTALS FROM STATEMENT
                                                AND/OR FORM 4562

2 TOTALS .................... 0,000,000 ******************2.
3 DEPRECIATION IN C-1.....................................3.
4 BALANCE, ENTER ON PART II, LINE 13                      4.      0,000,000.
******** SCHEDULE C-3 EXPENSE ACCOUNT INFORMATION ************************

    ENTER INFORMATION FOR YOURSELF AND 5 HIGHEST PAID EMPLOYEES. TO DETERMINE
    HIGHEST PAID EMPLOYEES, ADD EXPENSE ACCT. TO SALARIES AND WAGES.
                 NAME                    EXP. ACCOUNT      SALARIES/WAGES
                 (A)                        (B)                 (C)
    OWNER ............................   0,000,000.        0,000,000.
1   (1ST HIGHEST PAID EMPLOYEE'S NAME)
2   (2ND                            )
3   (3RD                            )
4                                      OR SEE STATEMENT XX
5
    DID YOU CLAIM A DEDUCTION FOR EXPENSES CONNECTED WITH:
A   ENTERTAINMENT FACILITY (BOAT, RESORT, RANCH, ETC.) .............(ANS)
B   LIVING ACCOMODATIONS (EXCEPT EMPL. ON BUSINESS) ................(ANS)
C   CONVENTIONS OR MEETINGS OUTSIDE THE UNITED STATES ..............(ANS)
D   EMPLOYEES' FAMILIES AT CONVENTIONS/MEETINGS ....................(ANS)
    IF YES, WERE ANY OUTSIDE OF U.S. OR POSSESSIONS ................(ANS)
E   VACATIONS FOR EMPLOYEES AND FAMILIES NOT ON W-2 ................(ANS)
```

EXHIBIT CG - D (SCHEDULE D - PAGE 1)



```
SCHEDULE D                    CAPITAL GAINS AND LOSSES                1981 * 14
(FORM 1040)                                              OMB NC. 1545-0074
JOHN Q. & MARY J. TAXPAYER                                  SSN 000-00-0000
***************************************************************************
**************** PART I - SHORT-TERM CAPITAL GAINS AND LOSSES ***************

    (A)            (B)    (C)       (D)          (E)          (F)          (G)
1  KIND OF        DATE   DATE      GROSS       COST OR     LOSS: (E)    GAIN: (D)
   PROPERTY       ACQ.   SOLD    SALE PRICE     BASIS       LESS (D)     LESS  (E)
(1ST)            MM/YY MM/YY   0,000,000.   0,000,000.   0,000,000.     0,000,000.
(2ND)
(3RD)                OR SEE STATEMENT XX

-----------------------------------------------------------------------------
2A GAIN FROM SALE/EXC RES.HELD 1 YEAR OR LESS 2A.XXXXXXXXXX        0,000,000.
 B SHORT-TERM CAP & GAIN (FROM F 6252          2B.
3 YOUR SHARE OF NET S-TERM GAIN PARTN/FUDIC... 3.  0,000,000.      0,000,000.
4  ADD LN 1, 2, 3, COLS F & G ............... 4.
5  COMBINE LN 4, COLS F & G ...................................5.
6  SHORT TERM (LOSS) CARRYOVER (AFTER 1969)....................6.
7  NET ST GAIN OR LOSS  ADD LNS 5 & 6..........................7 .     0,000,000.
**************** PART II - LONG-TERM CAPITAL GAINS AND LOSSES ***************

8 (1ST)       MM/YY MM/YY   0,000,000.  0,000,000.   0,000,000.        0,000,000.
  (2ND)
  (3RD)
                     OR SEE STATEMENT XX


9A GAINS FROM SALE/EXC RES. HELD OVER 1 YEAR..9A. XXXXXXXXXX       0,000,000.
 B LONG-TERM CAP GAIN - INSTALL. SALES (F6252)9B.

10  YOUR SHARE NET L-TERM GAIN LOSS PARTN/FUDIC 10.0,000,000.   0,000,000.
11  ADD LNS 8, 9 & 10, COLS F & G ............ 11.
12  ADD LN 11 COL F & G, ENTER GAIN OR LOSS ...............12.
13  CAPITAL GAIN DISTRIBUTIONS ............................13.
14  GAIN FROM FORM 4797 ...................................14.
15  YOUR SHARE NET L-TERM GAIN FROM S-BUSINESS CORP........15.
16  ADD LNS 12 THRU 15 ....................................16.
17  L-TERM CAPITAL LOSS CARRYOVER AFTER 1969 ..............17.
18  NET L-TERM GAIN OR (LOSS)  ADD LNS 16 AND 17 ..........18.    0,000,000.


       SCHEDULE D CONTINUED ON PAGE 2
```

EXHIBIT CG - D (SCHEDULE D - PAGE 2)

```
SCHEDULE D (CON'T) PG 2
(FORM 1040)
JOHN Q.& MARY J. TAXPAYER                                       SSN  000-00-0000
*******************  PART III    SUMMARY OF PARTS I & II  ********************
19  ADD LINE 7 & 18........................................................ 19.
20  IF LINE 19 IS GAINED ENTER SMALLER OF LINE 18 OR 19........ 20.
21  ENTER 60% of LINE 20.......................................................21.
22  SUBTRACT LINE 21 from line 19. ...........................................22.
23  IF LN 19 LOSS, ENTER ONE OF THE FOLLOWING AMOUNTS: ..........23.
    (I) IF LINE 7 IS ZERO OR A NET GAIN, ENTER 50% OF LINE 19,
    (II) IF LINE 18 IS ZERO OR A NET GAIN, ENTER LINE 19; OR
    (III)IF LN 7 & 18 ARE LOSS, ENTER LN 7 AMT + 50% LN 18
24  ENTER SMALLEST OF LINE 23, $3000 or ADJ TAXABLE INCOME......24.
*****************************************************************************
PART IV  COMPUTATION OF ALTERNATIVE TAX
25  NET SHORT TERM GAIN OR (LOSS) FROM LINE 5,..................25.
26  NET LONG-TERM GAIN OR (LOSS) FROM LINE 16,.....................26.
27  IF LINE  26 SHOWS A GAIN, COMBINE LINE 25 AND LINE 26.......27.
    IF LINE 26 SHOWS A LOSS OR ZERO, ENTER ZERO AND DO NOT
28  ENTER THE SMALLER OF LINE 26 or LINE 27.......................28.
29  ENTER THE SMALLER OF LINE 20 or LINE 28.......................29.
30  ENTER YOUR TAXABLE INCOME FROM FORM 1040, LINE 34...........30.
31  ENTER 40% OF LINE 29..........................................31.
32  SUBTRACT LINE 31 FROM LINE 30. ...................................32.
33  TAX ON AMOUNT ON LINE 32.  TAX RATE SCHEDULE (X).............33.
34 ENTER 20% of line 29...............................................34.
35 ADD LN 33 and 34 ..................................................35.
*****************************************************************************
PART V  COMPUTATION OF POST-1969 CAPITAL LOSS CARRYOVERS (81 TO 82)
        SECTION A. - SHORT-TERM CAPITAL LOSS CARRYOVER
36  ENTER LOSS SHOWN ON LINE 7; IF NONE, ENTER ZERO .............36.
37  ENTER GAIN SHOWN ON LINE 18.......................................37.
38  REDUCE ANY LOSS ON LINE 36 TO EXTENT OF ANY GAIN ON 37......38.
39  ENTER AMOUNT SHOWN ON LINE 24.....................................39.
40  ENTER SMALLER OF LINE 38 or 39....................................40.
41  SUBTRACT LINE 40 FROM LINE 38.....................................41.
**************** SECTION B - LONG TERM CAP. LOSS CARRY OVER *****************
42  SUBTRACT LINE 40 FROM line 39 ....................................42.
43  ENTER LOSS FROM LINE 18;...........................................43.
44  ENTER GAIN SHOWN ON LINE 7: .......................................44.
45  REDUCE ANY LOSS ON LINE 43 TO EXTENT OF GAIN ON LINE 44.....45.
46  MULTIPLY AMOUNT ON LINE 42 BY 2..................................46.
47  SUBTRACT LINE 46 FROM LINE 45. ................................. 47.
PART VI  ELECTION OF INSTALLMENT METHOD
    (    ) I ELECT OUT OF INSTLLMENT METHOD-AMOUNT 00,000,000.-PERCENT     .XX
```

EXHIBIT CG - E (SCHEDULE E - PAGE 1)

```
SCHEDULE E      SUPPLEMENTAL INCOME SCHEDULE                   1981 #15
(FORM 1040                                       OMB NO. 1545-0074
JOHN Q. & MARY J. TAXPAYER                                SSN  000-00-0000
******************  PART I - RENT & ROYALTY INCOME/LOSS INCOME ************

1  EXPENSES FOR VACATION HOME/DWELLING RENTED TO OTHERS?                (ANS)

2  IF "YES" DID YOU OR FAMILY USE FOR MORE THAN 14 DAYS DURING THE YEAR?(ANS)
****************************************************************************

RENTAL AND ROYALTY INCOME                    :   PROPERTIES                TOTALS
DESCRIBE PROPERTY IN PART V                     A         B         C
                                         :        :        :        :
 3  A RENTS RECEIVED                     :00,000. : 00,000. : 00,000. :
    B ROYALTIES RECEIVED                 :        :        :        :  00,000,000.
****************************************************************************
RENTAL AND ROYALTY EXPEN.                :        :        :        :
 4  ADVERTISING                       4.:        :        :        :
 5  AUTO AND TRAVEL                   5.:        :        :        :
 6  CLEANING AND MAINTENANCE          6.:        :        :        :
 7  COMMISSIONS                       7.:        :        :        :
 8  INSURANCE                         8.:        :        :        :
 9  INTEREST                          9.:        :        :        :
10  LEGAL PROF FEES                  10.:        :        :        :
11  REPAIRS                          11.:        :        :        :
12  SUPPLIES                         12.:        :        :        :
13  TAXES NOT WINDFALL               13.:        :        :        :
14  UTILITIES                        14.:        :        :        :
15  WAGES AND SALARIES               15.:        :        :        :
16  OTHER (LIST)                     16.:        :        :        :
    (1ST)                               :        :        :        :
    (2ND)                               :        :        :        :
    (3RD)                               :        :        :        :
    (4TH) OR SEE STATEMENT              :        :        :        :
                                        :        :        :        :
                                        :        :        :        :
                                        :        :        :        :
                                        :        :        :        :
                                        :        :        :        :
                                        :        :        :        :
****************************************************************************

17  TOTAL DEDUCTIONS                 17.
18  DEPRECIATION EXPENSE             18.
19  TOTAL (ADD LINES 17              19.                           XXXXXXXXXXXXXX
20  INCOME OR (LOSS) FROM            20.                           XXXXXXXXXXXXXX
21  ADD PROFIT PROPERTIES                                   21.
22  ADD LOSS PROPERTIES                                     22.
23  COMBINE LNS 21/22                                       23.
24  NET FARM PROFIT/LOSS                                    24.
25  TOTAL RENT/ROYALTY INC.                                 25.

      SCHEDULE E CONTINUED ON PAGE 2
```

EXHIBIT CG - E (SCHEDULE E - PAGE 2)

```
SCHEDULE E (CONT'D) Page 2
(FORM 1040)                                                       SSN 000-00-0000
JOHN Q. & MARY J. TAXPAYER

*************************************************************************************
PART II  INCOME OR LOSS FROM PARTNERSHIPS,ESTATES OR TRUSTS,S-BUSINESS CORP.
         IF YOU HAVE LOSS BELOW, DO YOU HAVE AMTS NOT AT RISK            (ANS)
         IF YES, AND LOSS EXCEEDS YOU AMT AT RISK, DID YOU LIMIT AMT     (ANS)
(A) NAME       (B)   EIN       (C) NET LOSS                (D) NET INCOME
                                        00,000,000           00,000,000.
   (INSERT INFO HERE & BETWEEN LINES 29 & 30,31 & 32 AS NEEDED OR SEE STATEMENT X)
26    ADD AMOUNTS IN COLUMNS (C) and (D) 26.
27    COMBINE AMOUNTS IN (C) and (D) ENTERd NET INCOME  27.
28    ADDITIONAL DEPREC. FROM 1980/81 PARTNERSHIPS      28. 00,000,000.
29    TOTAL PARTNERSHIP INCOME LINES 27 and 28          29.
30    ADD AMOUNTS IN COLUMNS (C) AND (D) 30.
31    TOTAL ESTATE OR TRUST INCOME                      31.
32    ADD AMOUNTS IN COLUMNS (C) AND (D) 32.
33    TOTAL SMALL BUSINESS CORP. INCOME                 33.
PART III WINDFALL PROFIT TAX SUMMARY
34    WINDFALL PROFIT TAX CREDIT OR REFUND              34.
35    WINDFALL PROFIT TAX WITHHELD IN 1981              35.

PART IV   SUMMARY

37  TOTAL INCOME OR (LOSS).                             37.
38  FARMERS AND FISHERMEN                               38.

***************       PART V - DEPRECIATION CLAIMED IN PART I     ***************
    A) PROP             (B) DATE  (C)COST   (D)PRIOR   (E) DEPR   (F)  (G) DEPR
  DESCRIPTION          ACQUIRED             YR DEPR    METHOD     L/R    1981
PROPERTY A . . .
1ST                 (2/80  )   0,000,000. 0,000,000.     SL        L   0,000,000.
(ADD LINES AS NEEDED)
TOTAL PROP A                            OR SEE STATEMENT XX
*************************************************************************************
PROPERTY B
1ST
(ADD LINES AS NEEDED)                      OR SEE STATEMENT XX
TOTAL PROP B
*************************************************************************************
(C PROPERTY-ADD AS NEEDED)
                                                   OR SEE STATEMENT XX
```

EXHIBIT CG - F (SCHEDULE F - PAGE 1)

```
SCHEDULE F                  FARM INCOME  AND EXPENSES             1981 * 16
(FORM 1040)                                                 OMB NO. 1545-0074
JOHN Q. & MARY J. TAXPAYER                                    SSN  000-00-0000
AMERICAN FARM 0000 FARM ROAD, ANYTOWN, ANYSTATE  00000        EIN  00-0000000
********* PART I - FARM INCOME ************ PART II - FARM DEDUCTIONS *****
          CASH METHOD                         | CASH AND ACCRUAL METHOD
SALE OF PURCHASED LIVESTOCK & OTHER ITEMS     |
(A) DESCRIBE      (B)AMT REC'D    (C) COST    |
 1 LIVESTOCK      0,000,000.   0,000,000.     |
    SEE STATEMENT XX                          |
 2 OTHER ITEMS                                | 32A LABOR HIRED ....0,000,000.
    SEE STATEMENT XX                          | 32B JOBS CREDIT
 3 TOTALS........0,000,000.    0,000,000.     | 32C WIN CREDIT .....
 4 PROFIT(LOSS) L3 LESS L3C    0,000,000.     | 32D TOTAL CREDITS ..
                                              | 32E BALANCE ........
** LVSTK & PROD SALES + OTHER FARM INCOME**?
          KIND                     AMOUNT     | 33 REPAIRS .........
 5 CATTLE/CALVES............. 0,000,000.      | 34 INTEREST ........
 6 SHEEP.............                         | 35 RENT OF FARM ....
 7 SWINE.....................                 | 36 FEED PURCHASED ..
 8 POULTRY...................                 | 37 SEEDS & PLANTS ..
 9 DAIRY PRODUCTS............                 | 38 FERTILIZERS, LIME
10 EGGS......................                 | 39 MACHINE HIRE ....
11 WOOL......................                 | 40 SUPPLIES PURCH ..
12 COTTON ...................                 | 41 BREEDING FEES ...
13 TOBACCO...................                 | 42 VET & MEDICINE ..
14 VEGETABLES................                 | 43 GAS, FUEL, OIL ..
15 SOYBEANS   ...............                 | 44 STORAGE .........
16 CORN       ...............                 | 45 TAXES ...........
17 OTHER GRAINS..............                 | 46 INSURANCE .......
18 HAY/STRAW   ..............                 | 47 UTILITIES .......
19 FRUITS AND NUTS...........                 | 48 FREIGHT, TRUCKING
20 MACHINE WORK..............                 | 49 CONSERVATION EXP.
21 A PATRONAGE DIVIDENDS.....                 | 50 LAND CLEARING ...
   B LESS NON-INCOME ITEMS...                 | 51 PENSION & PROFIT
   C NET PATRONAGE DIVID.....                 |    SHARING .........
22 PER UNIT RETAINS..........                 | 52 EMPL BENEFIT ....
23 NONPATRONAGE DISTRIBUTION                  | 53  OTHER (SPECIFY).
24A AGRIC.PMTS CASH PMTS.....                 | (1ST)   OR SEE STATEMENT XX
  B MATERIALS/SERVICES.......                 | (2ND)
25 COMMODITY CREDIT LOANS....
26 FEDERAL GAS TAX CREDIT....                 |
27 STATE GAS TAX REFUND......                 |
28 CROP INS PROCEEDS.........                 | 54 ADD LINES 32E-53
29 OTHER-SPECIFY-SEE STMT XX.                   55 DEPR (FORM 4562)
30 ADD LNS 5 THRU 29......... 000,000.00        56 TOTAL DEDUCT
31 GROSS PROFITS ADD LNS 4&30 000,000.00      |
****************************************************************************
57 NET FARM PROFIT/LOSS LN 31 LESS LN 56      |
****************************************************************************
58 IF, LOSS, DO YOU HAVE AMTS FOR FARM THAT ARE NOT "AT RISK" (ANS)
****************************************************************************

      SCHEDULE F CONTINUED ON PAGE 2
```

EXHIBIT CG - F (SCHEDULE F - PAGE 2)

```
SCHEDULE F (CON'T)        PAGE 2                                1981 * 17
(FORM 1040)
JOHN Q. & MARY J. TAXPAYER                                SSN   000-00-0000
********************** PART III - FARM INCOME - ACCURAL METHOD ****************
A. KIND                 B. INV.BEGIN YR. C. COST    D. SALES    E. INVENTORY-YR END
------------------------------------------------------------------------------
59 CATTLE/CALVES       :          :          :          :
60 SHEEP               :          :          :          :
61 SWINE               :          :          :          :
62 POULTRY             :          :          :          :
63 DAIRY PRODUCTS      :          :          :          :
64 EGGS                :          :          :          :
65 WOOL                :          :          :          :
66 COTTON              :          :          :          :
67 TOBACCO             :          :          :          :
68 VEGETABLES          :          :          :          :
69 SOYBEANS            :          :          :          :
70 CORN                :          :          :          :
71 OTHER GRAINS        :          :          :          :
72 HAY AND STRAW       :          :          :          :
73 Fruits/NUTS         :          :          :          :
74 MACHINE WORK        :          :          :          :
75 OTHER (SPECIFY)     :          :          :          :
   (1ST)               :          :          :          :
   (2ND)               :          :          :          :
   (3RD) OR SEE        :          :          :          :
         STATEMENT     :          :          :          :
                       :          :          :          :
                       :          :          :          :

*************************************************************************
PART IV  SUMMARY OF INCOME AND DEDUCTIONS ACCRUAL METHOD
*************************************************************************
77 INVENTORY OF LIVESTOCK, CROPS; PRODUCTS/END OF YEAR          77.
78  SALES OF LIVESTOCK, CROPS, AND PRODUCTS AT END OF YEAR......78
79  AGRICULTURE PROGRAM PAYMENTS: A CASH.......................79A.
                                  B MATERIALS AND SERVICES.....79B.
80  COMMODITY CREDIT LOANS UNDER ELECTION (OR FORFEITED)........80.
81  FEDERAL GASOLINE TAX CREDIT.................................81.
82  STATE GASOLINE TAX REFUND...................................82.
83  OTHER FARM INCOME (SPECIFY).................................83.
84  ADD LINES 77 THROUGH 83.....................................84.
85  INVENTORY AT BEGINNING OF YEAR..............................85.
86  COST - LIVESTOCK & PRODUCTS PURCHASED DURING YEAR...........86.
87  TOTAL (ADD LINES 85 and 86).................................87.
88  GROSS PROFITS (SUBTRACT LINE 87 FROM LINE 84............. .88.
89  TOTAL DEDUCTIONS FROM PART II, LINE 56......................89.
90  NET PROFIT/LOSS (SUBTRACT LINE 89 FROM LINE 88..............90.
91  IF LOSS - DO YOU HAVE AMOUNTS NOT AT RISK?..................91. (ANS)
```

EXHIBIT CG - G (SCHEDULE G)

```
SCHEDULE G                           INCOME AVERAGING                       1981 * 20
(FORM 1040)                                     OMB NO. 1545-0074
JOHN Q AND MARY J TAXPAYER                                              SSN 000-00-0000
******************** BASE PERIOD INCOME AND ADJUSTMENTS *******************
                                      (A)          (B)          (C)          (D)
                                 1ST PREC YR  2ND PREC YR  3RD PREC YR  4TH PREC YR
                                     1980         1979         1978         1977

  1 AMT FROM FORM 1040/1040A    00,000.00    00,000.00    00,000.00    00,000.00
  2A EXMPT  X $750 ............XXXXXXXXX    XXXXXXXXX
   B EXMPT  X $1000 ...........                           XXXXXXXXX    XXXXXXXXX
  3 TAXABLE INCOME L1-L2A/B...
  4 INC NOT U.S. EARNED......
  5 BASE INCOME (3+4=5)......

******************** COMPUTATION OF AVERAGEABLE INCOME ********************
  6 TAXABLE INCOME                                                  6.
  7 CERTAIN AMOUNTS RECEIVED BY OWNER-EMPLOYEES
    SUBJECT TO PENALTY, SECTION 72(M)(5)......................     7.
  8 SUBTRACT LINE 7 FROM LINE 6...............................     8.
  9 EXCESS COMMUNITY INCOME ..................................     9.
 10 ADJUSTED TAXABLE INCOME (LN 8-LN  9) ZERO IF NEGATIVE...  10.
 11 ADD COLUMNS (A) THROUGH (D), LINE 5.......................    11.
 12 ENTER 30% OF LINE 11......................................    13.
 13 AVERAGEABLE INCOME (SUBTRACT LINE 12 FROM LINE 10)......     13.

***************************** COMPUTATION OF TAX ***************************
 14 AMOUNT FROM LINE 12 ......................................    14.
 15 20% OF LINE 13............................................    15.
 16 TOTAL (ADD LINES 14 AND 15)...............................    16.
 17 EXCESS COMMUNITY INCOME FROM LINE 9 ......................    17.
 18 TOTAL (ADD LINES 16 AND 17)...............................    18.
 19 TAX ON AMOUNT ON LINE 18..................................    19.
 20 TAX ON AMOUNT ON LINE 16..................................    20.
 21 TAX ON AMOUNT ON LINE 14 .................................    21.
 22 SUBTRACT LINE 21 FROM LINE 20.............................    22.
 23 MULTIPLY THE AMOUNT ON LINE 22 BY 4 ......................    23.
 24 TAX ON AMOUNT ON LINE 6...................................    24.
 25 TAX ON AMOUNT ON LINE 8...................................    25.
 26 SUBTRACT LINE 25 FROM LINE 24.............................    26.
 27 ADD LINES 19, 23 & 26.....................................    27.
 28 Multiply Line 27 x .0125..................................    28.
 29 Tax Subtract Line 28 From Line 27.........................    29.
```

EXHIBIT CG - R (SCHEDULE R)

```
SCHEDULE R                    CREDIT FOR THE ELDERLY                1981 * 21
(FORM 1040)                                        OMB NO. 1545-0074
JOHN Q. TAXPAYER                                                SSN 000-00-0000
*******************************************************************************
         SCHEDULE R - INDIVIDUAL(S) 65 OR OVER HAVING ANY KIND OF INCOME

FILING STATUS   (B XX  MARRIED FILING JOINT RETURN, ONLY ONE OVER 65 )

1  ENTER     $3750, $2500 OR $1875.............................. 1. 000,000.00
2A ENTER AMOUNTS RECEIVED AS NON-TAX PENSIONS OR ANNUITIES.. 2A.
2B ENTER AMOUNT FROM FORM 1040 LN 32A....................... 2B.
2C ENTER      $10,000, $7500 OR $5000 ...................... 2C.
2D LINE 2B LESS LINE 2C..................................... 2D.
2E ENTER 50% OF LINE 2D..................................... 2E.
3  ADD LINES 2A AND 2E...................................... 3.
4  SUBTRACT LINE 3 FROM LINE 1.............................. 4.
5  MULTIPLY LINE 4 BY 15% .................................. 5.
6  ENTER AMOUNT OF TAX FROM FORM 1040, LINE 37.............. 6.
7  ENTER SMALLER AMOUNT FROM LINE 5 OR LINE 6 .............. 7.
  (ENTER THIS AMOUNT ON FORM 1040, LINE 39)
*******************************************************************************
```

EXHIBIT CG - RP (SCHEDULE RP)

```
SCHEDULE RP  CREDIT FOR ELDERLY  UNDER 65 YEARS                    1981 * 21
(FORM 1040)                                        OMB NO. 1545-0074
JOHN Q.& MARY J. TAXPAYER                                       SSN 000-00-0000
*******************************************************************************

FILING STATUS  ( )     MARRIED FILING JOINT RETURN, ONE UNDER 65

                                                  (A)                  (B)

1   ENTER   $3750, $2500 OR $1875 .......  1.  00,000.00           00,000.00
2A  ENTER AMTS REC'D NON-TAX (PENS, ANNUT).2A.
2BI (UNDER 62) ENTER ALL OVER $900 .......2BI.
2BII(62) + ENTER AMTS PER INSTRUCTIONS.. 2BII.
3   ADD LINES 2A AND 2B .................  3.
4   SUBTRACT LINE 3 FROM LINE 1...........  4.
5A (UNDER 65)ENTER OTHER $ NOT ON LN 2A... 5A.
5B (65+)ENTER OTHER $ RECEIVED ........... 5B.
6   ENTER SMALLER OF LN 4 OR 5 ...........  6.
7   ADD COLS (A) & (B) LINE 6 ............  7.
8   MULTIPLY LINE 7 BY 15% ...............  8.
9   ENTER  TAX FROM FORM 1040, LINE 37....  9.
10  ENTER SMALLER OF LN 8 OR 9............ 10.
 (ENTER THIS AMOUNT ON FORM 1040, LINE 39)
```

EXHIBIT CG - SE (SCHEDULE SE)

```
                                                              1981 * 22
SCHEDULE SE
          COMPUTATION OF SOCIAL SECURITY SELF-EMPLOYMENT TAX
                                              OMB NO. 1545-0074
(FORM 1040)                                             SSN 000-00-0000
MARY J. TAXPAYER
**********************************************************************
****** PART I - COMPUTATION OF NET EARNINGS FROM FARM SELF-EMPLOYMENT *****

  1A  NET PROFIT/LOSS FROM  SCHEDULE F.....................1A.    0,000,000.
  1B  NET PROFIT/LOSS FROM FARM PARTNERSHIPS...............1B.
  2   NET EARNINGS FROM FARMS   (ADD LNS 1A & 1B).......... 2.
  3A  IF GROSS PROFITS NOT $2400+  ENTER 66% OF GROSS, OR...3.
   B  IF GR PROFIT $2400+  NET NOT $1600 ENTER $1,600
  4   AMOUNT FROM LINE 2 OR LINE 3.........................4.
**************************************************************************
 **** PART II - COMPUTATION OF NET EARNING FROM NONFARM SELF-EMPLOYMENT ****

  5A NET PROFIT/LOSS FROM SCHEDULE C...................... 5A.
  5B PARTNERSHIPS, JOINT VENTURES, ETC.................... 5B.
  5C SERVICE AS MINISTER, MEMBER OF RELIGIOUS ORDER,ETC... 5C.
  5D SERVICE WITH A FOREIGN GOVT. OR INT'L ORG............ 5D.
  5E OTHER: SPECIFY- SEE STATEMENT XX..................... 5E.
  6 TOTAL (ADD LINES 5A THRU 5E)..........................  6.
  7 OTHER ADJUSTMENTS - SEE STATEMENT XX..................  7.
  8 ADJUSTED NET EARNINGS (LOSS) (LN 6 LESS LN 7).........  8.
  9A MAX AMOUNT REPORTABLE USING BOTH OPTIONAL METHODS.... 9A.         1,600.
  9B AMOUNT ON LINE 3..................................... 9B.
  9C BALANCE (LN 9A LESS LN 9B............................ 9C.
 10 SMALLER OF 2/3 OF GROSS NONFARM PROFITS OR $1,600..... 10.
 11 SMALLER OF LN 9C OR 10................................ 11.
 ****** PART III - COMPUTATION OF SOCIAL SECURITY SELF-EMPLOYMENT TAX ******

 12A  NET EARNINGS (LOSS) FROM FARMING (LINE 4)...........12A.
 12B  FROM NONFARM (LINE 8, OR 11 IF OPTION USED).........12B.
 13   TOTAL NET EARNINGS (LOSS)  ADD LN 12A & 12B..........13.
 14   THE LARGEST AMOUNT SUBJECT TO 1981 S. S. TAX:....... 14.        29,700.
 15A  TOTAL FICA FROM W-2 FORM OR RRTA....................15A.
 15B  UNREPORTED TIPS FROM FORM 4137 OR RRTA..............15B.
 15C  TOTAL OF LNS 15A & 15B..............................15C.
 16 BALANCE (LINE 14 LESS LINE 15C)........................16.
 17 SELF-EMPLOYMENT INCOME (SMALLER OF LINE 13 OR 16)......17.
 18 S-EMPLY TAX.(LN 17 $29700 = $2762.10  OR LN 17X.093)...18.
```

26 CFR 601.602: Forms and instructions.
(Also Part I, Sections 402, 408, 1232, 3402, 6041, 6042, 6043, 6044, 6047, 6049, 6050A, 6050B; 1.6041-1, 1.6042-2, 1.6044-2, 1.6047-1, 1.6049-1, 1.6050A-1, 7.6041-1, 31.3402(p)-1.)

Rev. Proc. 82-5

PART A. GENERAL

SECTION 1. PURPOSE

.01 The purpose of the revenue procedure is to state the requirements for reproducing paper substitutes of the following forms:

(a) Form 1099R, Statement for Recipients of Total Distribution from Profit-Sharing, Retirement Plans, and Individual Retirement Arrangements.

(b) Form 1099-DIV, Statement for Recipients of Dividends and Distributions.

(c) Form 1099-INT, Statement for Recipients of Interest Income.

(d) Form 1099-MISC, Statement for Recipients of Miscellaneous Income.

(e) Form 1099-MED, Statement for Recipients of Medical and Health Care Payments.

(f) Form 1099-OID, Statement for Recipients of Original Issue Discount.

(g) Form 1099-PATR, Statement for Recipients (Patrons) of Taxable Distributions Received From Cooperatives.

(h) Form 1099-L, U.S. Information Return for Distributions in Liquidation During Calendar Year.

(i) Form 1099-F, Statement for Certain Fishing Boat Crewmembers.

(j) Form 1099-BCD, Statement for Recipients of Interest on Bearer Certificates of Deposit.

(k) Form 1087-DIV, Statement for Recipients of Dividends and Distributions.

(l) Form 1087-INT, Statement for Recipients of Interest Income.

(m) Form 1087-MISC, Statement for Recipients of Miscellaneous Income.

(n) Form 1087-MED, Statement for Recipients of Medical and Health Care Payments.

(o) Form 1087-OID, Statement for Recipients of Original Issue Discount.

(p) Form W-2G, Statement for Certain Gambling Winnings.

(q) Form 1099-ASC, Statement for Recipients of Interest on All-Savers Certificates.

(r) Form 1099-UC, Statement for Recipients of Unemployment Compensation Payments.

(s) Form 1099-NEC, Statement for Recipients of Nonemployee Compensation.

(t) Form 1087-ASC, Statement for Recipients of Interest on All-Savers Certificates.

.02 For the purpose of this revenue procedure, a substitute form is one which does not totally conform to the specifications set forth. Payee copies are not to be considered substitute forms. Only Copy A data need be approved.

.03 This revenue procedure supersedes Rev. Proc. 79-17, 1979-1 C.B. 516.

SEC. 2. NATURE OF CHANGES

.01 New return types, Forms 1099-ASC, 1087-ASC, 1099-NEC, and 1099-UC, have been added.

.02 Requirement for OMB Approval Numbers has been added.

.03 Instructions for payee copies have been clarified (i.e. what a taxpayer must provide to a payee).

.04 A new section has been added to detail which payee TIN should be reported.

.05 Specifications for each type of Form 1099, 1087, and W-2G have been standardized so that the requirements are the same for all (i.e., exceptions removed).

.06 Various Editorial Changes.

SEC. 3. APPLICATION FOR APPROVAL OF SUBSTITUTE FORMS 1099, 1087, AND W-2G, COPY A

.01 Paper substitutes for Forms 1099, 1087 and W-2G which totally conform to the specifications contained in this procedure may be privately printed without prior approval from the Internal Revenue Service.

.02 Proposed substitutes not conforming to these specifications, must be submitted by payers for consideration to:

Commissioner of Internal Revenue
Attn: TX:R:I
1111 Constitution Ave., N.W.
Washington, DC 20224

These requests should contain copy of the proposed form, the nee for the specific deviation(s), and th volume of information returns a fected.

.03 Forms 1099, 1087, and W-2 are subject to annual review and poss ble change. Payers are cautioned therefore, against overstocking supplies of the privately printed subst tutes.

.04 Copies of the official forms fo the reporting year may be obtaine from most Internal Revenue office The Service provides only cut shee (no carbon interleaves) of these forms

.05 Only original or ribbon copie may be filed with the Internal Revenue Service. Carbon copies and reproduced copies are not acceptable.

SEC. 4. DEFINITIONS

.01 The term "taxpayer (recipien identifying number" for an individua means the social security numbe (SSN). The SSN consists of nine-digi separated by hyphens as follows: 000 00-0000. For all other payees, the ter "taxpayer (recipient) identifying number" means employer identificatio number (EIN). The EIN consists o nine-digits separated by one hyphen a follows: 00-0000000.

.02 The terms Payee and Recipien are usually synonymous. The name o the appropriate payee (i.e. person o organization whose tax identifyin number has been provided) must b shown as the first entry in the area o the form provided for the payee' name and address. No descriptive information or other individual's nam are to precede the payee's name ONLY one payee name should appear. If more are needed, place the responsible payee (person who will report the income for tax purposes) o the first line. Place other payees o succeeding lines.

.03 A Corrected and/or Amende return is one which corrects previousl reported information.

SEC. 5. INSTRUCTIONS

.01 Recipient name, street address city, state, and ZIP Code informatio must be on separate lines. It is preferred that the city, state, and ZIP Code be on the same line.

.02 The clear area to the right of the payee's name and address is available for the account designation number. This information is not required; however, special caution must be taken if an account designation number is being printed. This number must not appear in the "Recipients Identifying Number" box, the payment amount boxes, or in the box provided for the payee's name and address.

.03 The Service requests that payers type or machine print whenever possible, provide quality data entries on the forms (i.e. use black ribbon, insert data in the middle of blocks well separated from other printing and guidelines), and take other measures to guarantee a clear, sharp image. Payers are not required, however, to acquire special equipment solely for the purpose of preparing these forms.

.04 On corrected returns, an "X" must be placed in the check box in the left ½ inch margin following the "format identifier number" (e.g., Form 1099-DIV, 91). The words CORRECTED RETURN must be typed in all caps in the top ¼ inch, right-of center margin. All required data blocks must be completed on a corrected return since it replaces and supersedes the information return previously filed.

.05 Substitute forms prepared in continuous or strip form must be burst and stripped to conform to the size specified for a single form before they are filed with the Service.

SEC. 6. TAXPAYER IDENTIFICATION NUMBERS

.01 Under Section 6109 of the Internal Revenue Code, recipients of dividends, interest, or other payments are required to furnish taxpayer identification numbers (TINs) to the payer. The number must be furnished to the payer whether or not the payee is required to file a tax return or is covered by Social Security. Section 6109 also requires payers to request recipient TINs and furnish such on returns filed with the Service.

.02 The Service expects that payers will keep to a minimum those statements submitted without TINs. It is particularly important that correct social security and employer identification numbers for payees be provided on magnetic media or paper forms submitted to the Service.

.03 For each omission of a required TIN, Section 6676 of the Internal Revenue Code provides that the Service charge a $5 penalty, unless the payer or payee responsible for furnishing the number supplies an explanation, upon request from the Service, that establishes reasonable cause for not having done so.

.04 The TIN to be furnished the Service depends primarily upon the manner in which the account is maintained or set up on the record of the payer. The number to be provided must be that of the owner of record. If the account is recorded in more than one name, furnish the TIN and name of one of the holders of the record. The number provided must be associated with the name of the holder provided in the first name line. The payee TIN is the recipient's Social Security Number of individuals (including those individuals operating a business as a sole proprietorship) or the recipient's Employer Identification Number of other entries.

.05 Sole proprietors who are payers should show their employer identification numbers as a Payer; however, the payer should use the social security number of a sole proprietor when a payee.

.06 The charts below will help you determine the number to be furnished to the Service.

Chart 1. Guidelines for Social Security Numbers

For this type of account	For Payee TIN enter the Social Security Number of	In the Payee 1st Name Line of the Payee Portion of the Return Enter the Name of
1. An individual's account.	The individual.	The individual.
2. Joint account of: a. husband and wife.	The actual owner of the account. (If more than one owner, the principal owner.)	The individual whose SSN is entered.
b. adult and minor.	The actual owner of the account. (If more than one owner, the principal owner.)	The individual whose SSN is entered.
c. two or more individuals.	The actual owner of the account. (If more than one owner, the principal owner.)	The individual whose SSN is entered.
3. Account in the name of a guardian or committee for a designated ward, minor, or incompetent person.	The ward, minor, or incompetent person.	The individual whose SSN is entered.
4. Custodian account of a minor (Uniform Gifts to Minor Act).	The minor.	The minor.
5. a. The usual revocable savings trust account (grantor is also trustee).	The grantor-trustee.	The grantor-trustee.
b. So-called trust account that is not a legal or valid trust under State law.	The actual owner.	The actual owner.
6. Sole proprietorship.	The owner.	The owner.

Chart 2. Guidelines for Employer Identification Numbers

For this type of account	For Payee TIN enter the Employer Identification Number of	In the Payee 1st Name Line of the Payee Portion of the Return Enter the Name of
1. A valid trust, estate, or pension trust.	Legal entity.	The legal trust, estate, or pension trust.
2. Corporate account.	The corporation.	The corporation.
3. Religious, charitable, or educational organization.	The organization.	The organization.
4. Partnership account held in the name of the business.	The partnership.	The partnership.
5. Association, club, or other tax-exempt organization.	The organization.	The organization.
6. A broker or registered nominee.	The broker or nominee.	The broker or nominee.
7. Accounts with the Department of Agriculture in the name of a public entity (such as a State or local government, school district, or prison that receives agriculture program payments.)	The public entity.	The public entity.

SEC. 7. MAGNETIC MEDIA FILING

.01 The Service encourages payers or nominees (hereafter collectively referred to as payers) with computer capability to file information returns on magnetic media instead of paper forms. All forms listed in Sec. 1.01, except Forms 1099-BCD, 1099F, and W-2G, may be filed on magnetic media. Specifications for filing information returns on tape, disk, or diskette are contained in revenue procedures, relating to Magnetic Tape Recording for Information Returns, Disk Pack Reporting for Information Returns, and Diskette Reporting for Information Returns. Copies of these procedures may be obtained from any Internal Revenue district office or service center. Payers or agents who want to file information returns on magnetic media must file an application, Form 4419, with the service center which normally receives the paper forms.

.02 Since many states accept information returns filed on magnetic media, savings may be obtained if similar media is used for filing with the Service and state tax agencies. For information regarding state magnetic media filing requirements, payers should contact the individual state tax authority.

PART B SUBSTITUTE FORM FORMAT REQUIREMENTS

SEC. 1. GENERAL

.01 The following specifications prescribe the format requirements of Forms 1099, 1087, and W-2G;—Copy A ONLY.

.02 Copies sent to Recipients need only (a) list all information needed to complete tax returns, (b) list all payee instructions provided for on the Official Internal Revenue Service formats, (c) meet local, state, etc. requirements, (d) contain the OMB number prescribed on the Official Service format, and (e) tell the payee(s) that the information is being furnished to the Service.

.03 A payer may file a substitute Form 1099, 1087, or W-2G with the Service (hereafter referred to as substitute Copy A). Substitute forms submitted to the Service must be exac replicas of the official forms with re spect to layout and contents. Only th dimensions of the substitute form ma differ and the printing of the Govern ment Printing Office symbol must b deleted.

.04 Color and Quality of Paper

1 Paper for Copy A must be whit chemical wood bond, or equivalent 40 pound (basis 17 x 22-1000), plus o minus 5 percent. No optical brighten ers may be added to the pulp or pape during manufacture. The paper mus consist of principally bleached chemi cal woodpulp and be free from un bleached or ground woodpulp or re cycled printed paper. It also must b suitably sized to accept ink withou feathering.

2 Copies B (For Recipient) and (For Payer) are provided in the offici assembly solely for the convenience the payer. Payers may choose the fo mat, design, color and quality of th paper used for these copies.

.05 Color and Quality of Ink—A printing must be in a high quality no gloss black ink. Bar codes should b free from picks and voids.

.06 Typography—Type must substantially identical in size an shape with corresponding type on th official form. All rules on the doc ment are either 1-point (0.015 inch) 3-point (0.045). Vertical rules must parallel to the left edge of the doc ment; horizontal rules, parallel to th top edge.

.07 Dimensions—The official for is 8 inches wide x 3⅔ inches deep, e clusive of a ½ inch snap stub on th left side of the form. The snap featu is not required on substitutes. If th substitute forms are in continuous strip form, they must be burst ar stripped to conform to the size spe fied for a single form before they are filed with the Service.

1 The width of a substitute Copy A must be a minimum of 7 inches and a maximum of 8 inches, although adherence to the size of the official form is preferred. If the width of the substitute Copy A is reduced from that of the official form, the width of each field, except the left margin and the "For Official Use Only" area, on the substitute form must be reduced proportionately. The left margin must be ½ inch and free of all printing other than that shown on the official form. The area marked "For Official Use Only" must be 3 inches.

2 The depth of a substitute Copy A must be a minimum of 3⅓ inches and a maximum of 3⅔ inches. If the depth is reduced from that of the official form, the margin area at the top of the form marked "Official Use Only" must be ½ inch in depth by three inches in width.

.08 Clear Area—The back of Copy A must be free of all printing.

.09 Carbonized forms or "spot carbons"—Carbonized forms and "spot carbons" are not permissible. Interleaved carbons, if used, must be of good quality to preclude smudging and should be black.

.10 Printer's Symbol—The Government Printing Office symbol must not be printed on substitute Forms 1099, 1087, or W-2G. In place thereof, the printer's Employer Identification Number should appear in the same place on such substitute forms.

.11 Other Copies—Copy B and C are included in the official assembly for the convenience of the payer. Although there is no requirement that privately printed substitute forms include these copies, Copy B will satisfy the requirement of law and regulations concerning the statement of information which is required to be furnished the payee. Copy C may be desired as a payer record/copy.

SEC. 2. ADDITIONAL INSTRUCTIONS

.01 Arrangement of Assembly—Except as provided in paragraph .02 below, the parts of the assembly shall be arranged, from top to bottom, as follows: Copy A (Original), "For Internal Revenue Service Center", Copy B, "For Payee" (Form 1099-OID for Record Owner), Copy C, "For Payer's Record" (1087-OID for Record Owner).

.02 Additional Copies—Additional copies may be prepared by payers for states REQUIRING THE REPORT. When this is done, one such copy may be inserted between Copies A and B. Forms for delivery to state or local taxing authorities should be clearly labeled to indicate the purpose for which they are intended and should not bear the Internal Revenue Service form number or the designation, "Department of the Treasury, Internal Revenue Service".

.03 Reproductions Proofs—Order blanks for reproduction proofs are mailed annually to requestors of record, and to other users upon request. Printers and others wishing to obtain reproduction proofs may send their requests to:

Internal Revenue Service
Attn: Distribution Manager
RM:FM:P
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

A charge of $1.00 per page will be made for each reproduction proof regardless of page size. Invoices will be made after orders are filled.

SEC. 3. OMB REQUIREMENTS

.01 Office of Management and Budget (OMB) Requirements for Substitute Forms. Pub. L. 96-511 requires: (1) OMB approval of Internal Revenue Service tax forms, (2) that each form show (in the upper right corner) the OMB approval number and any expiration date, and (3) the form (or its instructions) state why the Service is collecting the information, how we will use it and whether it must be given to us. The official Service forms will contain this information.

As it applies to substitute Service forms this means:

1. All substitute forms must show the OMB number and any expiration date as they appear on the official Service form.

2. The OMB number (and date) must use one of the following formats:

a. OMB No. XXXX-XXXX
(preferred)
or
OMB # XXXX-XXXX

b. OMB No. XXXX-XXXX
(preferred) Expires
XXXXXX (mmddyy)
or
OMB # XXXX-XXXX
Expires XXXXXX
(mmddyy)

c. OMB No. XXXX-XXXX
Expires XXXXXX
(mmddyy)
(preferred)
or
OMB # XXXX-XXXX Expires XXXXXX (mmddyy)

3. You must inform the users of your substitute forms of the reasons for Service collection, use and requirements, as stated in the instruction for the Service form.

4. The official OMB approval numbers (and expiration date) may be obtained from reproduction proofs, official Service printed forms, or when approval is requested for a substitute form.

SEC. 4. EFFECT ON OTHER DOCUMENTS

This Rev. Proc. supersedes Rev. Proc. 79-17.

---

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, Sections 6501, 6511; 301.6501(c)-1, 301.6511(c)-1.)

Rev. Proc. 82-6

This revenue procedure clarifies Rev. Proc. 72-38, 1972-2 C.B. 813, which prescribes conditions under which the Internal Revenue Service will accept one properly executed Form 872, Consent to Extend the Time to Assess Tax, Form 872-B, Consent to Extend the Time to Assess Miscellaneous Excise Taxes, or Form SS-10, Consent to Extend the Time to Assess Employment Taxes, covering a parent corporation and any or all of its subsidiary corporations.

Section 3.01 of Rev. Proc. 72-38 is amended by adding the following new subsection immediately after subsection 3:

4 No fixed percentage of ownership by the parent corporation is mandated. The subsidiaries included on the rider and covered by the consent may be less than wholly owned by the

parent corporation provided that all the conditions prescribed in this revenue procedure are met.

Rev. Proc. 72-38 is clarified. This clarification also applies to consents executed on Form 872-A, Special Consent to Extend the Time to Assess Tax, under section 3.04 of Rev. Proc. 79-22, 1979-1 C.B. 563.

---

26 CFR 601.602: Forms and instructions.
(Also Part I, Sections 6001, 6011; 1.6001-1, 1.6011-1.)

Rev. Proc. 82-7

SECTION 1. PURPOSE

The purpose of this revenue procedure is twofold: to state the requirements of the Internal Revenue Service regarding the reproduction, private design, and printing of substitute federal tax return Form 1040-ES, Declaration of Estimated Tax for Individuals, in lieu of the official form; and to state the Service's requirements regarding the acceptance of computer-prepared and computer-generated Forms 1040-ES.

SEC. 2 OFFICE OF MANAGEMENT AND BUDGET (OMB) REQUIREMENTS FOR ALL SUBSTITUTE FORMS

.01 *New Legal Requirements of the Paperwork Reduction Act of 1980.* Pub. L. 96-511 requires that: (1) OMB approve Internal Revenue Service tax forms, (2) each Service form must contain (near the upper right corner) the OMB approval number and any applicable expiration date, and (3) each Service form (or its instructions) state why the Service is collecting the information, how it will be used, and whether or not the information is required to be furnished.

.02 *Application to Substitute Forms.*

1 *Approval Number and Date Is Required.* All substitute Forms 1040-ES must contain near the upper right corner the OMB number that is on the Service form.

2 *Format Required*

OMB No. XXXX-XXXX (preferred)

or

OMB # XXXX-XXXX

3 *Required Explanation to Users of Substitute Forms.* You must also inform the users of your substitute forms of the Service use and collection requirements stated in the instructions for the official Service form.

.03 *Obtaining OMB Number, Date, and Statement.* The OMB approval number, expiration date (when applicable), and use and collection requirements may be obtained from the Service printed form (or its instructions), the reproduction proof (or instructions), or from the Service.

SEC. 3. DEFINITIONS

.01 *Definitions Used in This Procedure (Relating to 1040-ES Tax Forms).*

1 Substitute Form. A tax form that differs in any way from the official versions and is intended to replace the entire form printed and distributed by the Service. This term also covers those approved substitute formats and forms described in this revenue procedure. (A photocopy or a copy produced from an unchanged reproduction proof, supplied by the Service, is not a substitute form.)

2 Computer-Prepared Form. A preprinted form in which the taxpayer's name, address and tax entry information has been printed by a computer, computer-printer or other computer-type equipment, such as word-processing equipment.

3 Manually Prepared Form. A preprinted form in which the taxpayer's name, address and tax entry information is entered by an individual using pen, pencil, typewriter or other non-automated equipment.

4 Computer-Generated Tax Forms. A document that is entirely prepared by the use of a computer-printing device so that all the line numbers, line captions, and the tax amount data entries are in the same typeface. No graphics appear on the form.

5 Graphics. Those parts of the tax form that are not the tax amount entries or called-for information. Generally, these are line numbers, captions, instructions, rules and borders, special indicators, and rules or strokes created by typesetting, photo-graphics, photocomposition, etc.

6 Printed Form. A form produced using conventional printing processes, photocopying, or other similar processes.

7 Preprinted Pin-Fed Form. A form printed beforehand by conventional methods on paper with marginal perforations for use with automated and/or highspeed printing equipment.

SEC. 4. GENERAL INSTRUCTIONS

.01 When filing reproduced or privately printed Form 1040-ES, use the envelope enclosed with the taxpayer's 1040-ES package except as provided for in Sec. 5. The envelope is coded to identify the contents, to accelerate the processing, and to reduce processing costs. Do not use this envelope for other correspondence with the Service as its misuse could delay the correspondence.

02. Do not staple payment (check or money order, not cash) to the Form 1040-ES because removing it could cause tearing.

.03 The Service does not approve o disapprove the specific equipment o process used in reproducing officia forms, but requires only that the repro duced forms satisfy the condition stated in this revenue procedure.

.04 Reproduction meeting th above conditions may be used withou prior approval of the Service. Howeve specific approval of a reproduction substitute which deviates from these r quirements must be requested and sample of the proposed reproducti should be forwarded, by letter, to t Internal Revenue Service; Attentio Substitute Forms Program—TX:R 1111 Constitution Avenue, N.W Washington, D.C. 20224, for co sideration. Include how the form w be prepared and the weight of paper used in printing the form.

.05 You cannot use your own p printed label on tax returns filed w the Service. The ONLY label p mitted is the one provided the t payers in their 1040-ES tax packa Otherwise, the taxpayer's name address must be entered on the ret in the spaces provided.

.06 Preparers who desire to file s stitute Forms 1040-ES must dev such substitutes using guidelines in revenue procedure. Substitutes o than those described there must be proved by the Service before b filed.

.07 Changes to Tax Forms. person making changes to the F 1040-ES tax form (EXCEPT TH ALLOWED BY REVENUE PRO

DURES) must obtain approval from the Service before filing the substitute.

.08 First-time users of substitute forms that have been designed using computer graphics must obtain prior approval before using the substitute forms.

.09 Determination of requests for approval of substitute Forms 1040-ES will be made after the Service's copy is finalized, usually in mid-October. Proposed substitutes should be sent to the address in 4.04 above, as much in advance of the filing period for the form as possible. This is to allow adequate time for analysis and response and to permit notice to our field offices.

.10 Once an approval is granted for the use of privately printed forms, you may be requested to send eleven (11) copies of each approved form to the address shown in Sec. 4.04 above. Approval is for a one-year period only (January through December) and must be resubmitted each year even if no changes are made to the Form 1040-ES. (See exception in Sec. 8.)

SEC. 5. PHYSICAL ASPECTS

.01 The conditions with respect to size, quality of paper, and color of both paper and ink are as follows:

1 Largest size permitted is 8 × 3½ inches.

2 White paper and black ink.

3 Form must fit in the Service provided mailing envelope without folding.

4 Paper weight must equal or exceed the Service's form (40 lb. white writing paper).

5 Any privately provided envelope must contain the label "Form 1040-ES" on left center of envelope face (see official envelope for size and type of printing).

SEC. 6. REPRODUCTION PROOFS

.01 Specifications—Basic specifications such as margin, etc., will be printed in the top margin of the reproduction proofs and must be removed before printing. The official reproduction proof margins across the top, bottom, and sides must be maintained on all reproductions and privately printed Forms 1040-ES.

.02 Printers and others wishing to obtain reproduction proofs may send their requests to the Internal Revenue Service; Washington, D.C. 20224; Attention RM:FM:P. The request must include written agreement to pay charges upon receipt of an invoice. The Service mails invoices to requesters each July. A charge of $1.00 per page will be made for reproduction proofs regardless of page size.

SEC. 7. CONDITIONS

.01 Privately printed reproductions of Forms 1040-ES must meet the following conditions:

1 Must be exact facsimiles of the official forms. The private printing of these facsimilies must be produced by a photographic reproduction process.

2 Must be on chemical wood writing paper equal to or better than the quality used for official forms. The thickness of the stock should not be less than 0.0039 inch. Carbon bonded paper is prohibited from use for forms filed with the Service.

3 Must have a high standard of legibility, both as to original form and as to fill-in matter. The Service may reject reproductions with poor legibility.

.02 Reproduction of the official form and substitute forms which do not meet the requirements of this revenue procedure may not be filed in lieu of the official form.

SEC. 8. EXCEPTION TO NEED FOR WRITTEN APPROVAL

.01 If you have received written approval for a substitute form for use during calendar year 1981, you may design and use such forms for the 1982 calendar year without obtaining another written approval. This means that if you received written approval for a certain change or number of changes on a specified 1981 tax year form (not covered by other revenue procedures—such as Form 1042, W-2, 1099, etc.), you do not have to obtain written approval from the Service for the same changes for the 1982 tax year form PROVIDED: (1) you use the Official Service 1982 tax year form as your guide, and (2) you comply with the guidelines and instructions contained in current revenue procedures.

SEC. 9. COMPUTER-PREPARED FORMS 1040-ES

.01 You can FILL IN official Internal Revenue Service forms that have been privately prepared for use on computer or word processing equipment. These forms should be designed with a vertical spacing of six lines to the inch, and money amount columns wide enough to allow for the computer printing of ten characters.

.02 Adjustments. You may make minor vertical and horizontal spacing adjustments to allow for computer or word-processing printing. This includes widening the amount columns or tax entry areas so long as the adjustments do not exceed other provisions stated in revenue procedures. No prior approval is needed for these changes. However, the users of forms with such changes are bound by the "Agreement" in Sec. 12.

.03 You can ADJUST the graphics on printed Forms 1040-ES to allow for computer-printed or word processor fill-in. Only the areas listed in this revenue procedure may be changed without prior approval.

.04 Any other changes need prior written approval.

.05 You may omit all references to instructions on the form.

SEC. 10. COMPUTER-GENERATED FORMS 1040-ES

.01 All computer-generated forms must be prepared in the format shown in the exhibit included in this revenue procedure. The generated form should be 8 × 3¾ inches with vertical spacing of 6 lines per inch and horizontal spacing of 10 characters per inch.

.02 Margins. A one-quarter inch margin must be maintained across the top, bottom, and both sides (exclusive of any pin-fed holes) of all computer-generated substitutes. The margin allows for slight printing misalignment when forms are prepared on high-speed equipment.

SEC. 11. COMPUTER-GENERATED FORMS 1040-ES NOT SHOWN AS AN EXHIBIT IN THIS REVENUE PROCEDURE

.01 Persons or companies desiring to change the computer-generated Form 1040-ES shown in the exhibit MUST obtain prior approval before use.

.02 Format Arrangement. The format of each substitute form must follow the format of the official form as to item caption, line reference, line numbers, sequence, form arrangement and format, etc. Basically try to make the form look like the official one, with readability being a primary factor. Use periods and/or other special characters to separate the various parts and sections of the form. All line numbers and items must be printed even though an amount is not entered on the line.

.03 If you wish, you may submit any substitute form to the Service for approval consideration.

SEC. 12. AGREEMENT

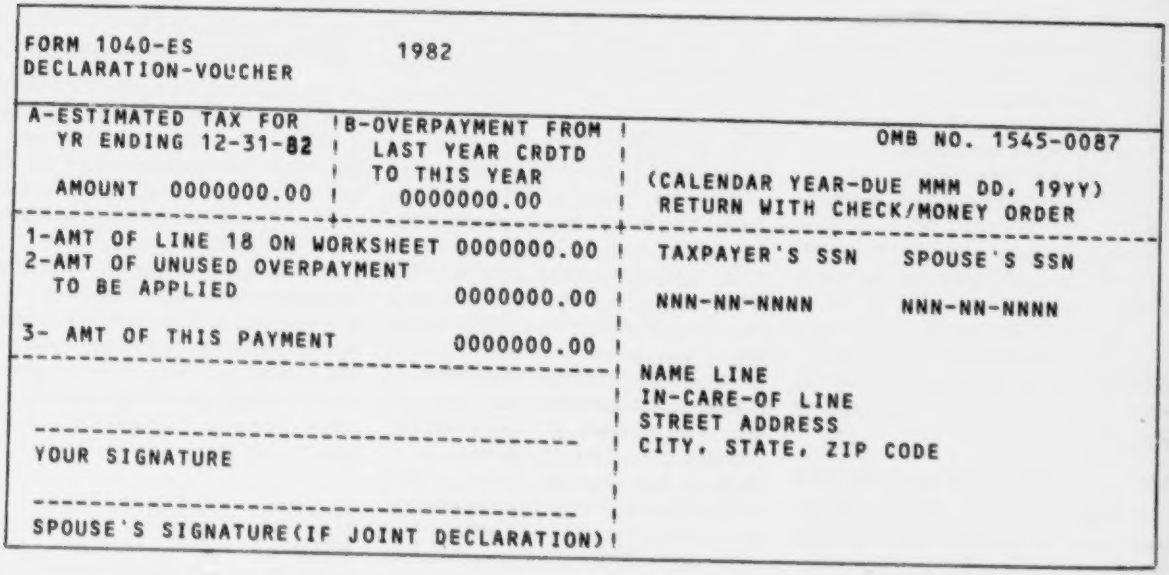
Any person who uses substitute forms and makes all or part of the changes specified in this revenue procedure, agrees to the following stipulation: the Service presumes the changes are made in accordance with these procedures and, as such, will be noninterruptive to the processing of the tax return. Should any of the changes prove to be not exactly as described, and as a result become disruptive to the Service during processing of the tax return, the preparer agrees to accept the determination of the Service as to whether or not the form may continue to b used during the filing season, and als agrees to work with the Service in cor recting noted deficiencies. Notificatio of deficiencies may be made by letter, phone call or both.

SEC. 13. EFFECT ON OTHER DOCUMENTS

This revenue procedure supersede Rev. Proc. 79-56, 1979-2 C.B. 539.

SEC. 14. EXHIBITS SECTION

EXHIBIT - COMPUTER GENERATED FORM 1040-ES



```
FORM 1040-ES               1982
DECLARATION-VOUCHER

A-ESTIMATED TAX FOR  !B-OVERPAYMENT FROM !
  YR ENDING 12-31-82 !  LAST YEAR CRDTD  !                   OMB NO. 1545-0087
                     !  TO THIS YEAR     ! (CALENDAR YEAR-DUE MMM DD, 19YY)
  AMOUNT  0000000.00 !    0000000.00     !  RETURN WITH CHECK/MONEY ORDER
---------------------+-------------------+-----------------------------------
1-AMT OF LINE 18 ON WORKSHEET 0000000.00 !  TAXPAYER'S SSN   SPOUSE'S SSN
2-AMT OF UNUSED OVERPAYMENT              !
  TO BE APPLIED               0000000.00 !  NNN-NN-NNNN      NNN-NN-NNNN
                                         !
3- AMT OF THIS PAYMENT        0000000.00 !
-----------------------------------------! NAME LINE
                                         ! IN-CARE-OF LINE
 -------------------------------------   ! STREET ADDRESS
 YOUR SIGNATURE                          ! CITY, STATE, ZIP CODE
                                         !
 -------------------------------------   !
 SPOUSE'S SIGNATURE(IF JOINT DECLARATION)!
```

26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 82-8

SECTION 1. BACKGROUND

Rev. Proc. 81-10, 1981-1 C.B. 647, sets forth areas in which advance rulings or determination letters will not be issued by the Internal Revenue Service. Section 3 of Rev. Proc. 81-10 is entitled, Areas in Which Rulings or Determination Letters Will Not Be Issued.

SEC. 2. PROCEDURE

Rev. Proc. 81-10 is hereby amended by adding to Section 3 the following new section:

Section 119.—Meals or Lodging Furnished For the Convenience of the Employer.—Whether the value of meals or lodging is excludable from gross income by an employee who is a controlling shareholder of the employer.

SEC. 3. EFFECTIVE DATE

This revenue procedure will apply to all ruling requests on hand in the National Office on February 16, 1982, the date of publication of this revenue procedure in the Internal Revenue Bulletin, as well as to requests received thereafter.

SEC. 4. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 81-10 is amplified.

---

26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also Section 2032A; 20.2032A-8.)

Rev. Proc. 82-9 [1]

SECTION 1. PURPOSE

The purpose of this revenue procedure is to provide guidelines for filing elections for special use valuation under section 2032A of the Internal Revenue Code, reinstatements of elections, and claims for credit or refund when estates qualify for special use valuation under the retroactive provisions of the Economic Recovery Tax Act of 1981.

SEC. 2. BACKGROUND

.01 Section 421 of the Economic Recovery Tax Act of 1981 made changes to Section 2032A of the Code. The changes are generally effective for estates of decedents dying after December 31, 1981. However, because certain changes are retroactive and apply to estates of decedents dying after December 31, 1976, estates that did not previously qualify for special use valuation may now qualify.

.02 Section 2032A of the Internal Revenue Code permits the executor of an estate of a decedent who died after December 31, 1976, to elect to value real property used as a farm or in a closely held business at its value based on its use as a farm or in the closely held business rather than at its fair market value.

.03 Section 20.2032A-8 of the Estate Tax Regulations provides that the election for special use valuation under Section 2032A is made on the federal estate tax return filed for the decedent's estate.

.04 Section 2032A(b)(1) of the Code provides that the property to be specially valued must have been used for a qualified use. Section 2032A(b)(1) also provides generally that a specified percentage of the adjusted value of the gross estate must consist of property used for a qualified use prior to the decedent's death. Under the retroactive changes made by the Economic Recovery Tax Act of 1981, the requirements for qualified use prior to the decedent's death may be satisfied if either the decedent or a member of the decedent's family used the property for the qualified use.

.05 Under section 2032A(c) of the Code, an additional estate tax is imposed if there is a "cessation of qualified use." To avoid a cessation of qualified use, the property must be continually used by the qualified heir personally after the decedent's death for the qualified use in which the decedent's estate valued the property. Under the retroactive changes, a delay by the qualified heir in the commencement of this qualified use for a period of less than 2 years is not a cessation of qualified use.

In addition, to avoid a cessation of qualified use, there must have been "material participation" in the operation of the farm or business by the decedent (or a member of the decedent's family), during the decedent's lifetime, and by the qualified heir (or a member of the qualified heir's family), after the decedent's death, with only limited interruption permissible during any 8-year period ending after the decedent's death. The period which will result in a cessation of qualified use has been changed from a cumulative period of "3 years or more" to "more than 3 years."

.06 Under the retroactive changes, active management after the decedent's death by an eligible qualified heir (or by a fiduciary for an eligible qualified heir who is under 21 or is disabled) is treated as material participation. Active management means the making of the management decisions of a business other than the daily operating decisions. An eligible qualified heir is the decedent's spouse or a qualified heir who 1) is a student, or 2) has not attained age 21, or 3) is disabled.

.07 Under section 2032A(b)(1) of the Code, property is eligible for special use valuation only if the property was acquired from or passed from the decedent to a qualified heir. Under the retroactive changes, property that is purchased from a decedent's estate or trust, as well as property that is received by bequest, devise, inheritance, or in satisfaction of a right to a pecuniary bequest, is considered to be acquired from the decedent.

.08 The retroactive changes also provide that an interest in a discretionary trust in which all the beneficiaries are qualified heirs is treated as a present interest. Therefore, property transferred to such a trust can now qualify for special use valuation.

.09 In general, these retroactive changes made by the Economic Recovery Tax Act of 1981 will apply to an estate only if an election for special use valuation under section 2032A was made when the federal estate tax return was timely filed.

.10 Notwithstanding the general rule of section 2.09, if the federal estate tax return was due after July 28, 1980, and was timely filed and if the executor did not make an election under section 2032A on that return, then, under the Act, the executor can now make the election. The election in this case must be made no later than February 16, 1982.

---

[1] Also released as New Release IR-82-20, dated February 4, 1982.

.11 A timely election that was made at any time after December 31, 1976, and was later revoked under section 20.2032A-8(d) of the Estate Tax Regulations can be reinstated no later than February 16, 1982.

.12 Where there has been an overassessment or overpayment of estate tax as a result of qualification for special use valuation under the retroactive changes, the executor should file a claim for refund or credit. The statute of limitations will not bar such a refund or credit, if the claim is made no later than February 16, 1982.

SEC. 3. GUIDELINES

The following guidelines will assist executors in filing and reinstating elections, and filing claims for credit or refund.

.01 An executor need not file a new notice of election for an estate or a notice of reinstatement of election if (1) a timely election was made when the federal estate tax return was filed and (2) the election was never revoked. However, in order to receive a credit for an overassessment of estate tax or a refund for an overpayment of estate tax, a claim for credit or refund must be made.

.02 If no election for special use valuation was ever made for an estate, an election can be made provided that a timely election could have been made after July 28, 1980, and a timely federal estate tax return was filed. To be effective, the election must be made no later than February 16, 1982, if the estate tax return is due on or before such date. The election should be clearly labeled with the heading "Notice of Election Under Section 2032A" and filed with the Internal Revenue Service Center where the decedent's federal estate tax return was filed. The notice of election should include all of the information that is required for an election that is made when a federal estate tax return is originally filed. The notice of election should also include a binding agreement by all persons with an interest in the property. The agreement must show their consent to be subject to the additional estate tax imposed under section 2032A(c) in the event of a disposition of the property or a cessation of the qualified use. The information and agreement requirements are contained in section 20.2032A-8(a)(3) and (c)(1) of the regulations.

.03 If a timely election was made when a federal estate tax return was filed and the election was later revoked, the election can be reinstated. To be effective, the reinstatement must be made no later than February 16, 1982. The reinstatement of election should be clearly labeled with the heading "Notice of Reinstatement of Election Under Section 2032A" and filed with the Internal Revenue Service Center where the decedent's federal estate tax return was filed. The notice of reinstatement should contain all of the information and the agreement that is required for an election that is made when a federal estate tax return is originally filed. If the agreement filed with the original election is currently binding on all parties and designates the correct agent, a new agreement need not be executed. However, a copy of the original agreement should be provided.

.04 A claim for credit or refund of estate tax may be made by filing Form 843, Claim, with the Internal Revenue Service. Form 843 is available at all Internal Revenue Service offices. However, no credit or refund is allowable unless an effective election for special use valuation is filed (or, if applicable, reinstated).

.05 In those cases where claims arising under the retroactive provisions would otherwise be barred by the statute of limitations on or before February 16, 1982, the claims will be effective if filed on or before February 16, 1982.

.06 In those cases where claims arising under the retroactive provisions are not barred by the statute of limitations on February 16. 1982, the time for making a claim for credit or refund is 3 years from the date the federal estate tax return was filed or 2 years from the date the tax was paid, whichever of these periods expires the later.

---

26 CFR 602: Forms and instructions.
(Also Part I, Sections 4997; 150.4997-2.)

Rev. Proc. 82-10

PART A—GENERAL

SECTION 1. PURPOSE AND NATURE OF CHANGES

The purpose of this revenue procedure is to update Rev. Proc. 81-13, 1981-1 C.B. 654, concerning the requirements and conditions for filing annual information returns for windfall profit tax on magnetic tape instead of on paper returns. Specifications for filing Form 6248, Annual Information Return of Windfall Profit Tax, are contained in this procedure. For Tax Year 1981 the following changes have been included in this revenue procedure:

.01 Expansion of all Records to 1450 characters in length.

.02 Expansion of the maximum block size to 14,500 characters in length.

.03 Inclusion of up to eight lines of Producer Name/Address information and deletion of separate name, address, city and state field in the Producer/Recipient "H" record.

.04 Inclusion of optional fields for owner's I.D. and Preparation Date in the Producer/Recipient "H" record.

.05 Certain fields in the Producer/Recipient "H" record are now optional. These fields are indicated in the layout of the "H" record.

SEC. 2. APPLICATION FOR MAGNETIC MEDIA REPORTING

.01 For the purpose of this revenue procedure the first purchaser, filer, and payer is the same and is considered to be the person making the payments. The producer, recipient, or payee is the receiver of the payments. The transmitter is the organization preparing the tape file. Payers or transmitters who decide to file information returns on magnetic tape must complete Form 4419, Application for Magnetic Media Reporting of Information Returns. Instructions for completing the application appear on the reverse side of the form.

.02 The Service will act on an application and notify the applicant of authorization to file within 30 days of receipt of the application. No magnetic tape returns may be filed with the Service until authorization to file is received.

.03 The Service will assist new filers

with their initial magnetic tape submission by reviewing test tapes in advance of the filing season. Approved payers or transmitters who wish to submit test tapes should contact the magnetic media coordinator at the Service Center where the application was filed. A list of the Service Center addresses is provided in Section 10.

.04 Once authorization to file on magnetic tape has been granted to a payer or transmitter, it will remain in effect in succeeding years, provided that all the requirements of this revenue procedure are met and there are no equipment changes by the filer. If a filer discontinues filing on magnetic tape, a new application must be filed before this method of filing may be resumed.

SEC. 3. FILING OF TAPE REPORT

.01 A magnetic tape reporting package, which includes all the necessary transmittals, labels, and instructions, will be mailed to all approved filers between October and December of each year.

.02 Payers may submit a portion of their information returns on magnetic tape and the remainder on paper forms provided there is no duplicate filing. The magnetic tape records and paper forms must be filed at the same location, but in separate shipments. A Form 6248-T, Summary and Transmittal of Windfall Profit Tax, must accompany paper submissions and a Form 4804, Transmittal of Information Returns Reported on Magnetic Media, must accompany magnetic tape submissions.

.03 The affidavit which appears on Forms 6248-T and Form 4804 must be signed by the payer. One of the following may, however, sign the affidavit on behalf of the payer if three conditions are met; the transmitter, service bureau, or disbursing agent. The conditions are that the Agent must:

a. have the authority to sign the affidavit under an agency agreement (either oral, written, or implied) that is valid under state law;

b. have the responsibility (either oral, written or implied) conferred on it by the payer to request the taxpayer identifying numbers of payees reported on magnetic tape or paper returns; and

c. sign the affidavit and add the caption "From: (name of payer)".

.04 Although a duly authorized agent signs the affidavit, the payer is held responsible for the accuracy of the Form 4804 and will be liable for penalties for failure to comply with filing requirements.

.05 The preceding requirements also apply to paper filers submitting Form 6248-T. The failure of duly authorized "agents" of paper filers to comply with filing requirements for Form 6248-T and attachments does not relieve the payers of any penalties that may arise as a result of such failure to comply.

.06 If a portion of the returns are submitted on paper documents, include a statement on the Form 6248-T that the remaining returns are being filed on magnetic tapes. Please note that Form 6248-T instructions normally apply to filing of information returns on paper; however, filers of magnetic tape must review the Form 6248-T instructions and file Form 6248-T if appropriate.

SEC. 4. FILING DATES

.01 Magnetic tape reporting to the Service for Forms 6248 is on a calendar year basis.

.02 The dates prescribed for filing paper returns with the Service will also apply to magnetic tape filing. Tapes must be submitted to the service center by April 30. Copies required to be furnished to the producer or other recipients must be furnished by March 31.

SEC. 5. EXTENSIONS OF TIME TO FILE

.01 If a payer or transmitter is unable to submit the tape file by the date prescribed in Section .02 above, a letter requesting an extension must be filed before April 30. The letter should be sent to the attention of the magnetic media coordinator at the service center which will receive the tape file. The request should include the estimated number of returns which will be filed late, the reason for the delay, and the date by which the returns will be filed.

.02 If an extension is granted by the Service, a copy of the letter granting the extension must be attached to the transmittal Form 4804 when the file is submitted.

SEC. 6. PROCESSING OF TAPE RETURNS

.01 The Service will process tax information from the tapes. Tapes which are timely received by the Service will be returned to the filer within six months of receipt.

.02 All tapes submitted must conform totally to this revenue procedure. If tapes are unprocessable, they will be returned to the filer for correction. Corrected tapes must be filed with the Service as soon as possible. Corrected files will be returned by the Service within six months of receipt.

SEC. 7. CORRECTED RETURNS, SUBSTITUTE FORMS AND COMPUTER-GENERATED FORMS

.01 If a large volume of corrected returns is necessary, and the payer or transmitter possesses the capability to provide such corrections on tape, they are encouraged to do so. The filer must contact the magnetic media coordinator for format and shipping instructions. A corrected Form 4804 must accompany the shipment and be marked "Magnetic Media Correction" on the upper portion of the form.

.02 If corrections are not submitted on tape, payers must submit them on official Forms 6248 (Copy A). Approved substitutes or computer-generated forms that are exact facsimiles of the official form (except for minor page size or print style deviations) may be submitted without obtaining prior Service approval, before the substitute or computer-generated form can be used. These restrictions are imposed because of the Service's requirement to report to Congress.

.03 Requests for approval of a computer-generated or substitute form should be sent to the following address with a copy of the proposed form:

Internal Revenue Service
Attn: Substitute Forms Program
Room 7033 TX:R:I
1111 Constitution Avenue N.W.
Washington, D.C. 20224

.04 Form 6248 instructions are to

be followed when paper returns are filed to corrected returns submitted on magnetic media. The caption "Magnetic Media Correction" must appear on the top right corner of the form. Corrections must be sent to the attention of the magnetic media coordinator where the original tape file was filed.

SEC. 8. TAXPAYER IDENTIFICATION NUMBERS

.01 Under Section 6109 of the Internal Revenue Code, recipients of income are required to furnish taxpayer identification numbers (TINs) to the payer whether or not the payee is required to file a tax return.

.02 Payers are expected to keep to a minimum those statements submitted without TINs. It is particularly important that correct social security and employer identification numbers for payees be provided on magnetic media or paper forms submitted to the Service.

.03 For each omission of a required TIN, Section 6676 of the Internal Revenue Code imposes a $5 penalty, unless the payer or payee responsible for furnishing the number establishes reasonable cause for not having done so.

.04 The TIN to be furnished depends primarily upon the manner in which the account is maintained or set up on the record of the payer. The number to be provided must be that of the owner of record. If the account is recorded in more than one name, furnish the TIN and name of one of the holders of the record. For those engaged in a trade or business (including employee trusts, retirement systems, etc.) the TIN is the employer identification number, EIN (without hyphens). For individuals, it is a social security number, SSN (without hyphens).

.05 Sole proprietors who are payers should show their employer identification numbers in the Filer/Transmitter "G" Record. However, the payer should use the social security number of a sole proprietor in the Producer/Recipient "H" Record.

.06 Any person required to file an information return that is based in whole or in part, upon information received from another person MUST include the taxpayer identifying number of that person on the return. The tables below will help determine the number to be furnished to the Service.

Table 1. Guidelines for Social Security Numbers

If the producer/recipient is:	In tape positions 2-10 of the Producer/Recipient "H" Records, enter the SSN of:	In tape positions 20-339 of the Producer/Recipient "H" Record, enter the name of:
1. An individual	The individual	The individual
2. A joint account of two or more individuals, a husband and wife, or adult and minor	The actual or principal owner of the account	The individual whose SSN is entered
3. An account in the name of the guardian or committee for a designated ward, minor, or incompetent person	The ward, minor, or incompetent person	The individual whose SSN is entered
4. A custodian of a minor (Uniform Gifts to Minor Acts)	The minor	The minor
5. a. The usual revocable savings trust account (grantor is also trustee)	The grantor-trustee	The grantor-trustee
b. So-called trust account that is not a legal or valid trust under State Law	The actual owner	The actual owner
6. A sole proprietor	The owner	The owner
7. A grantor trust described in Section 1.671-4(b) of the Income Tax Regulations	The grantor	The grantor

Table 2. Guidelines for Employer Identification Numbers

If the producer/recipient is:	In tape positions 11-19 of the Producer/Recipient "H" Record, enter EIN of:	In tape positions 20-339 of the Producer/Recipient "H" Record, enter the name of:
1. A valid trust, estate or pension trust	Legal entity (Do not furnish the identifying number of the personal representative or trustee unless the legal entity itself is designated in the account title)	The legal trust, estate, or pension trust

Table 1. Guidelines for Social Security Numbers (continued)

If the producer/recipient is:	In tape positions 2-10 of the Producer/Recipient "H" Records, enter the SSN of:	In the tape positions 20-339 of the Producer/Recipient "H" Record, enter the name of:
2. A corporation	The corporation	The corporation
3. A religious, charitable or educational organization	The organization	The organization
4. A partnership held in the name of the business	The partnership	The partnership
5. An association, club, or other tax-exempt organization	The organization	The organization
6. A broker or registered nominee	The broker or nominee	The broker or nominee
7. An account with the Department of Agriculture in the name of a public entity (such as a state or local government, school district or prison that receives agriculture program payments)	The public entity	The public entity

SEC. 9. EFFECT ON PAPER RETURNS

.01 Magnetic tape reporting of the information listed in Section 1 above applies only to the original (Copy A).

.02 Payers are permitted considerable flexibility in designing the copy of the information return to be furnished to the payee. The payer may combine the information return data with other reports of financial or commercial notices, or expand them to include other information. This is permissable so long as all required information present on the official form is included and the payees' copies are conducive to proper reporting of income on tax returns. Payers must include the message "This information is being furnished on Form 6248 to the Internal Revenue Service" on the recipients' copies.

.03 If a portion of the returns are reported on magnetic tape and the remainder are reported on paper forms, those returns not submitted on magnetic tape must be filed on official Forms 6248.

SEC. 10. ADDITIONAL INFORMATION

Requests for additional copies of this revenue procedure or for additional information on tape reporting should be addressed to the attention of magnetic media coordinator of one of the following:

(a) Internal Revenue Service
Andover Service Center
Post Office Box 311
Andover, MA 01810

(b) Internal Revenue Service
Brookhaven Service Center
P.O. Box 486
Holtsville N.Y. 11742

(c) Internal Revenue Service
Philadelphia Service Center
Post Office Box 245
Bensalem, PA 19020

(d) Internal Revenue Service
Atlanta Service Center
Post Office Box 47421
Doraville, GA 30362

(e) Internal Revenue Service
Memphis Service Center
P.O. Box 1900
Memphis, TN 38101

(f) Internal Revenue Service
Cincinnati Service Center
Post Office Box 267
Covington, KY 41019

(g) Internal Revenue Service
Kansas City Service Center
2306 E. Bannister Road Stop 43
Kansas City, MO 64131

(h) Internal Revenue Service
Austin Service Center
Post Office Box 934
Austin, TX 78767

(i) Internal Revenue Service
Ogden Service Center
Post Office Box 9941
Ogden, UT 84409

(j) Internal Revenue Service
Fresno Service Center
Post Office Box 12866
Fresno, CA 93779

PART B.—MAGNETIC TAPE SPECIFICATIONS

SEC. 1. GENERAL

.01 The magnetic tape specifications contained in this part prescribe the required format and contents of the records to be included in the file. These specifications must be adhered to unless deviations have been specifically granted by the Service in writing.

.02 In most instances, the Service will be able to process any compatible tape files. Compatible tape files must meet any one set of the following:

(a) 7 channel BCD (binary coded decimal) with

(1) Either Even or Odd Parity and

(2) A density of 556 or 800 BPI

(b) 9 channel EBCDIC (Extended Binary Coded Decimal Interchange Code) with

(1) Odd Parity and

(2) A density of 800 or 1600 BPI

(c) 9 channel ASCII (American Standard Coded Information Interchange) with

(1) Odd Parity and

(2) A density of 800 or 1600 BPI

.03 Although the Service can process, after translation, tapes created at 6250 BPI, it is preferred that filers submit 1600 BPI tapes if possible. If only 6250 BPI can be produced please contact your local magnetic media coordinator prior to shipping the tapes.

.04 All compatible tape files must have the following characteristics:

(a) Type of tape—½ inch Mylar

base, oxide coated; and

(b) Interrecord Gap—¾ inch.

.05 Service programs are capable of accommodating some minor deviations. Filers who can substantially conform to these specifications, but do require some minor deviations, must contact the magnetic media coordinator at the service center where the file will be submitted. Under no circumstances may tapes deviating from the specifications in this revenue procedure be submitted without prior written approval from the Service.

SEC. 2. RECORD LENGTH

.01 The tape records prescribed in these specifications may be blocked or unblocked, subject to the following:

(a) A block must not exceed 14,500 tape positions.

(b) If the use of blocked records would result in a short block, all remaining positions of the block must be filled with 9's. Do not pad a block with blanks.

(c) All records except the Header and Trailer Labels, may be blocked.

.02 All records, other than Header and Trailer records, must be 1450 characters long.

SEC. 3. OPTIONS FOR FILING

.01 For filing convenience, this procedure contains two options for using Header Labels and Filer/Transmitter "G" Records. For the purposes of this procedure the following conventions must be used:

Header Label:

1. Payers may use standard headers, provided they begin with 1HDR, HDR1, VOL1 or VOL2.
2. Consist of a maximum of 80 positions each.
3. May not contain the letters G, H. I, J, or K in position 9.

Trailer Label:

1. Standard trailer labels may be used provided that they begin with 1EOR, 1EOF, EOR1, or EOF1.
2. Consist of a maximum of 80 positions each.

Record Mark:

1. Special character used to separate blocked records on tape.
2. Can be written only at the end of a record or block.
3. For odd parity tapes, use BCD bit configuration 011010 ("A82").

Tape Mark:

1. Used to signify the physical end of the recording on tape.
2. For even parity, use BCD configuration 001111 ("8421").
3. May follow the header label and precede and/or follow the trailer label.

Option 1: When using this option, a correct Filer/Transmitter "G" Record, described in Sec. 4 below, is required as the first record on each reel. Filers using this option may have Header Labels preceding the "G" Record, however, headers are not required. The reel sequence number must appear in positions 3-5 of each "G" Record and must be incremented by 1 on each tape reel of the file after the first reel.

Option 2: Requires a Header Label as the first record on each reel. The Header Label must contain the reel sequence number and it must be incremented by 1 on each reel. The "G" Record will contain the location of the reel sequence number in the Header Label. If your system generates a four digit reel sequence number, ignore the first digit when determining the location of the reel sequence in the "G" Record.

Example 1: If your Header Label reel sequence is four digits (e.g., 0001) and is in positions 28-31, enter 29 as the location in positions 3 and 4 of the "G" Record and also enter an "X" in position 5 of the "G" Record.

Example 2: If your Header Label reel sequence number is 3 digits (e.g., 001) and is in position 10-12, enter 10 as the location in positions 3 and 4 of the "G" Record. This option requires a Trailer Label at the end of each reel. Also, ignore the "J" Record instructions in this part if you use option 2.

SEC. 4. FILER/TRANSMITTER "G" RECORD

This record identifies the filer and the transmitter of the tape file and provides parameters for the processing of the succeding records. The Service computer programs rely on the parameters supplied in this record in the processing of the tape file.

The number of "G" Records appearing on a tape reel will depend on the number Filers for whom data is present. A transmitter may include Producer "H" Records for more than one Filer on a tape reel, however, each series of separate Filer/Producer "H" Record(s) must be preceded by a "G" Record. A "G" Record may be blocked with "H" Records, however, the "G" Record must appear as the first record in the Block. All "G" Records must be 1,450 characters in length.

RECORD NAME: FILER/TRANSMITTER "G" RECORD

Tape Position	Field Title	Length	Description and Remarks
1	Record Type	1	Required. Enter "G".
2	Filing Year	1	Required. Must be the rightmost digit of the year for which WPT data is being reported (e.g., if data is for 1981 enter a 1). This number must be incremented each year.
3-5	Reel Sequence Number	3	Optional. Sequential number of the reel within the tape file upon which this record appears (see explanation of Option 1 and Option 2 filing). Position 5 must contain an X if you are using option 2.

RECORD NAME: FILER/TRANSMITTER "G" RECORD (continued)

Tape Position	Field Title	Length	Description and Remarks
6-9	"G" Record Length	4	Required. Enter 1450.
10-13	"H" Record Length	4	Required. Enter 1450.
14-17	"I" Record Length	4	Required. Enter 1450.
18	Type of Account Filer's TIN	1	This field is used to identify the data in tape positions 19-27 as either an EIN (Employer Identification Number) or a SSN (Social Security Number). Use one of the following codes as appropriate. 1. Use the digit 0 if the number provided is an SSN. 2. Use the digit 1 if the number provided is an EIN. 3. Use the digit 2 if it is not known if the number provided is an SSN or EIN. 4. Use the digit 3 if no number if provided (positions 19-27 should be blank filled in this case).
19-27	Filer's Taxpayer Identification Number	9	Required. Enter the taxpayer identifying number of the filer (SSN or EIN as appropriate). If no TIN is provided leave blank.
28-67	Filer's Name	40	Required. Enter the name of the Filer as used in normal business. Please delete any extraneous data other than the name. Left justify and fill with blanks.
68-102	Filer's Street Address	35	Enter the street address of the Filer. Left justify and fill with blanks. If Filer does not have a street address this field must be blank.
103-115	Filer's City	13	Enter the city of the Filer. Left justify and blank fill. If city is not known this field must be blank filled.
116-117	Filer's State	2	Enter the two digit abbreviation of the Filer's state. If state is not know this field must be blank filled.
118-122	Filer's Zip	5	Enter the Zip Code of the Filer. If Zip Code of the Filer is not known this field must be blank.
123-126	Reserved Field	4	Reserved for IRS use. Enter blanks.
127	Corrected Indicator	1	Enter a 1 (one) if the documents being filed are corrected documents. Otherwise enter a 0 (zero).
128	Producer Name/Address Line Indicator	1	Enter the maximum number of address lines that will be used in the following Producer/Recipient "H" records. Up to 8 Name/Address lines are allowed.
129-178	Reserved	50	Reserved for IRS use. Enter blanks.
179-183	Transmitter Control Code	5	Required. Enter the 5 digit transmitter control code assigned by IRS.
184	Transmitter Code	1	If the filer of these Forms 6248 and the transmitter are the same enter the digit 0 in this location and blank fill the rest of the record. If they are not the same enter the digit 1 and supply the information indicated.
185-193	Reserved	9	Reserved for IRS use. Blank fill.
194-233	Transmitters Name [1]	40	Enter the name of the Transmitter. Left justify and blank fill.

---

[1] If file is being transmitted by Filer, Transmitter Name, Street Address, City, State and Zip Code can be blank filled.

RECORD NAME: FILER/TRANSMITTER "G" RECORD (continued)

Tape Position	Field Title	Length	Description and Remarks
234-268	Transmitter's Street Address [1]	35	Enter the street address of the transmitter. Left justify and blank fill.
269-281	Transmitter's City [1]	13	Enter City of Transmitter. Left Justify and blank fill.
282-283	Transmitter's State [1]	2	Enter abbreviation of state of transmitter.
284-288	Transmitter's Zip Code [1]	5	Enter Zip Code of Transmitter.
289-1450	Reserved	1162	Reserved for IRS use. Blank fill.

[1] If file is being transmitted by Filer, Transmitter Name, Street Address, City, State and Zip Code can be blank filled.

SEC. 5. PRODUCER/RECIPIENT "H" RECORD

.01 This record is used to provide the information contained in Parts I, II, III, IV, and V of Form 6248. All "H" Records must be of the same fixed length. Records may be blocked or unblocked. A block may not exceed 14,500 positions. Do not pad unused blocks with blank records, fill with 9's. Blank fill any field for which a data entry is not present.

.02 All amount fields in this section should be expressed in whole dollars without decimals. All quantities of oil should be expressed in whole barrels without decimals or fractions. All "H" Records must be 1450 characters long

RECORD NAME: PRODUCER/RECIPIENT "H" RECORD

Tape Position	Field Title	Length	Description and Remarks
1	Record Type	1	Required. Enter "H".
2-10	Producer's SSN	9	Required. Enter Social Security Number of Producer, without hyphens, if available. Otherwise, blank fill.
11-19	Producer's EIN	9	Required. Enter Employer Identification Number of Producer, without hyphen, if available. Otherwise blank fill.
NOTE:	The following 8 fields are for the Producer Name/Address information. If your name/address fields contain less than 40 characters, do not pack information from more than one of your name/address field into any one of the following name/address fields. If your name/address fields are longer than 40 characters each, contact the magnetic media coordinator at your regional Service Center (see Part A Section 11 of this document) for instructions on entering the data.		
20-59	Producers 1st Name/Address Line	40	Enter data from your first Name/Address field for this Producer.
60-99	Producers 2nd Name/Address Line	40	Enter data from your second Name/Address field for this Producer.
100-139	Producers 3rd Name/Address Line	40	Enter data from your third Name/Address field for this Producer. If no data is present enter blanks.
140-179	Producers 4th Name/Address Line	40	Enter data from your fourth Name/Address field for this Producer. If no data is present enter blanks.
180-219	Producers 5th Name/Address Line	40	Enter data from your fifth Name/Address field for this Producer. If no data is present enter blanks.
220-259	Producers 6th Name/Address Line	40	Enter data from your sixth Name/Address field for this Producer. If no data is present enter blanks.

RECORD NAME: PRODUCER/RECIPIENT "H" RECORD (continued)

Tape Position	Field Title	Length	Description and Remarks
260-299	Producers 7th Name/Address Line	40	Enter data from your seventh Name/Address field for this Producer. If no data is present enter blanks.
300-339	Producers 8th Name/Address Line	40	Enter data from your eighth Name/Address field for this Producer. If no data is present enter blanks.
340-344	Producer Zip Code	5	Enter the Zip Code of the Producer. If Zip Code is not known field must be blank.
345-348	Reserved	4	Reserved for IRS use.
349-351	Type of Producer	3	Use up to 3 of the codes below to indicate the Type of Producer. Use at least one of the codes. Left justify and blank fill. *Type of Producer* *Code* Individual 1 Partnership 2 Corporation 3 Estate 4 Trust 5 US Citizen or Entity or Resident Alien 6 Resident of US Possession 7 Foreign Citizen or Non-Resident Alien Entity 8
352-354	Producer Status	3	Required. Use up to 3 of the following codes to indicate the status of the producer. Use at least one code. Left justify and blank fill. *Producer Status* *Code* Independent Producer 1 Member of "related group" 2 Producer with no withholding 3 Royalty Owner 4 Integrated Oil Company 5 Operator 6 Working Interest 7
355-364	Exempt Tier One Governmental	10	Enter the number of barrels of Exempt Tier One Oil From Qualified Governmental Interest.
365-374	Exempt Tier Two Governmental	10	Enter the number of barrels of Exempt Tier Two Oil From Qualified Governmental Interest.
375-384	Exempt Newly Discovered Governmental	10	Enter the number of barrels of Exempt Tier Three Newly Discovered Oil From Qualified Governmental Interest.
385-394	Exempt Incremental Tertiary Governmental	10	Enter the number of barrels of Exempt Tier Three Incremental Tertiary Oil from Qualified Governmental Interests.
395-404	Exempt Heavy Governmental	10	Enter the number of barrels of Exempt Tier Three Heavy Oil from Qualified governmental interests.
405-414	Exempt Tier One Charitable	10	Enter the number of barrels of Exempt Tier One Oil from qualified charitable interests.
415-424	Exempt Tier Two Charitable	10	Enter the number of barrels of Exempt Tier Two Oil from qualified charitable interests.
425-434	Exempt Newly Discovered Charitable	10	Enter the number of barrels of Exempt Tier Three Newly Discovered Oil from qualified charitable interests.

RECORD NAME: PRODUCER/RECIPIENT "H" RECORD (continued)

Tape Position	Field Title	Length	Description and Remarks
435-444	Exempt Incremental Tertiary Charitable	10	Enter the number of barrels of Exempt Tier Three Incremental Tertiary Oil from qualified charitable interests.
445-454	Exempt Heavy Charitable	10	Enter the number of barrels of Exempt Tier Three Heavy Oil from qualified charitable interests.
455-464	Exempt Tier One Indian	10	Enter the number of barrels of Exempt Tier One Indian Oil
465-474	Exempt Tier Two Indian	10	Enter the number of barrels of Exempt Tier Two Indian Oil.
475-484	Exempt Newly Discovered Indian	10	Enter the number of barrels of Exempt Tier Three Newly Discovered Indian Oil.
485-494	Exempt Incremental Tertiary Indian	10	Enter the number of barrels of Exempt Tier Three Incremental Tertiary Indian Oil.
495-504	Exempt Heavy Indian	10	Enter the number of barrels of Exempt Tier Three Heavy Indian Oil.
505-514	Exempt Tier One Alaskan	10	Enter the number of barrels of Exempt Tier One Alaskan Oil.
515-524	Exempt Tier Two Alaskan	10	Enter the number of barrels of Exempt Tier Two Alaskan Oil.
525-534	Exempt Newly Discovered Alaskan	10	Enter the number of barrels of Exempt Tier Three Newly Discovered Alaskan Oil.
535-544	Exempt Incremental Tertiary Alaskan	10	Enter the number of barrels of Exempt Tier Three Incremental Tertiary Alaskan Oil.
545-554	Exempt Heavy Alaskan	10	Enter the number of barrels of Exempt Tier Three Heavy Alaskan Oil.
555-564	Exempt Tier One Front-End	10	Enter the number of barrels of Exempt Tier One Front-End Oil.
565-574	Exempt Tier Two Front-End	10	Enter the number of barrels of Exempt Tier Two Front-End Oil.
575-584	Exempt Newly Discovered Front-End	10	Enter the number of barrels of Exempt Tier Three Newly Discovered Front-End Oil.
585-594	Exempt Incremental Tertiary Front-End	10	Enter the number of barrels of Exempt Tier Three Incremental Tertiary Front-End Oil.
595-604	Exempt Heavy Front-End	10	Enter the number of barrels of Exempt Tier Three Heavy Front-End Oil.
605-616	Number of Barrels Other Oil Removed 70% Rate	12	Enter the number of barrels of Tier One Oil other than Sadlerochit Oil, subject to the 70% Tax rate, removed during the tax year.
617-628	Aggregate Value Other Oil [1] Removed 70% Rate	12	Enter the aggregate removal value of Tier One Oil other than Sadlerochit Oil, subject to the 70% Tax rate, removed during the tax year.
629-640	Aggregate Adjusted Value Other Oil [1] Removed 70% Rate	12	Enter the aggregate adjusted base value of Tier One Oil other than Sadlerochit Oil, subject to the 70% Tax rate, removed during the tax year.
641-652	State Tax Adjustment Other Oil [1] Removed 70% Rate	12	Enter the aggregate state severance tax adjustment for Tier One Oil other than Sadlerochit Oil, subject to the 70% Tax rate, removed during the tax year.

---

[1] These fields are optional under the regulations for filing for Tax Year '81, you are requested but not required to supply this information. These fields correspond to Part III columns b, c and d, Form 6248.

Tape Position	Field Title	Length	Description and Remarks
653-664	Tax Liability Other Oil Removed 70% Rate	12	Enter the tax liability for Tier One Oil other than Sadlerochit Oil, subject to the 70% Tax rate, removed during the tax year.
665-676	Number of Barrels Other Oil Removed 50% Rate	12	Enter the number of barrels of Tier One Oil other than Sadlerochit Oil, subject to the 50% Tax rate, removed during the tax year.
677-688	Aggregate Value Other Oil [1] Removed 50% Rate	12	Enter the aggregate removal value of Tier One Oil other than Sadlerochit Oil, subject to the 50% Tax rate, removed during the tax year.
689-700	Aggregate Adjusted Value Other Oil [1] Removed 50% Rate	12	Enter the aggregate adjusted base value of Tier One Oil other than Sadlerochit Oil, subject to the 50% Tax rate, removed during the tax year.
701-712	State Tax Adjustment Other Oil [1] Removed 50% Rate	12	Enter the aggregate state severance tax adjustment for Tier One Oil other than Sadlerochit Oil, subject to the 50% Tax rate, removed during the tax year.
713-724	Tax Liability Other Oil Removed 50% Rate	12	Enter the tax liability for Tier One Oil other than Sadlerochit Oil, subject to the 50% Tax rate, removed during the tax year.
725-736	Number of Barrels Sadlerochit Oil Removed 70% Rate	12	Enter the number of barrels of Tier One Sadlerochit Oil, subject to the 70% Tax rate, removed during the tax year.
737-748	Aggregate Value Sadlerochit Oil [1] Removed 70% Rate	12	Enter the aggregate removal value of Tier One Sadlerochit Oil, subject to the 70% Tax rate, removed during the tax year.
749-760	Aggregate Adjusted Value Sadlerochit [1] Oil Removed 70% Rate	12	Enter the aggregate adjusted base value of Tier One Sadlerochit Oil, subject to the 70% Tax rate, removed during the tax year.
761-772	State Tax Adjustment Sadlerochit Oil [1] Removed 70% Rate	12	Enter the aggregate state severance tax adjustment for Tier One Sadlerochit Oil, subject to the 70% Tax rate, removed during the tax year.
773-784	Tax Liability Sadlerochit Oil Removed 70% Rate	12	Enter the tax liability for Tier One Sadlerochit Oil, subject to the 70% Tax rate, removed during the tax year.
785-796	Number of Barrels Sadlerochit Oil Removed 50% Rate	12	Enter the number of barrels of Tier One Sadlerochit Oil, subject to the 50% Tax rate, removed during the tax year.
797-808	Aggregate Value Sadlerochit Oil [1] Removed 50% Rate	12	Enter the aggregate removal of Tier One Sadlerochit Oil, subject to the 50% Tax rate, removed during the tax year.
809-820	Aggregate Adjusted Value Sadlerochit [1] Oil Removed 50% Rate	12	Enter the aggregate adjusted base value of Tier One Sadlerochit Oil, subject to the 50% Tax Rate, removed during the tax year.
821-832	State Tax Adjustment Sadlerochit Oil [1] Removed 50% Rate	12	Enter the aggregate state severance tax adjustment for Tier One Sadlerochit Oil, subject to the 50% Tax rate, removed during the tax year.
833-844	Tax Liability Sadlerochit Oil Removed 50% Rate	12	Enter the liability for Tier One Sadlerochit Oil, subject to the 50% Tax rate, removed during the tax year.

---

[1] These fields are optional under the regulations for filing for Tax Year '81, you are requested but not required to supply this information. These fields correspond to Part III columns b, c and d, Form 6248.

Tape Position	Field Title	Length	Description and Remarks
845-856	Number Barrels Tier Two 60% Rate	12	Enter the number of barrels of Tier Two Oil, subject to a 60% Tax rate, removed this tax year.
857-868	Aggregate Value Tier Two 60% Rate [1]	12	Enter the aggregate removal value of the Tier Two Oil, subject to a 60% Tax rate, removed this tax year.
869-880	Adjusted Value Tier Two 60% Rate [1]	12	Enter the aggregate adjusted base value of the Tier Two Oil, subject to a 60% Tax rate, removed this tax year.
881-892	State Tax Adjustment Tier Two 60% [1] Rate	12	Enter the aggregate state severance tax adjustment for Tier Two Oil, subject to a 60% Tax rate, removed this tax year.
893-904	Tax Liability Tier Two 60% Rate	12	Enter the tax liability for the Tier Two Oil, subject to a 60% Tax rate, removed this tax year.
905-916	Number Barrels Tier Two 30% Rate	12	Enter the number of barrels of Tier Two Oil, subject to a 30% Tax rate, removed this tax year.
917-928	Aggregate Value Tier Two 30% Rate [1]	12	Enter the aggregate removal value of the Tier Tw Oil, subject to a 30% Tax rate, removed this tax year.
929-940	Adjusted Value Tier Two 30% Rate [1]	12	Enter the aggregate adjusted base value of the Tier Two Oil, subject to a 30% Tax rate, removed this tax year.
941-952	State Tax Adjustment Tier Two 30% [1] Rate	12	Enter the aggregate state severance tax adjustment for the Tier Two Oil, subject to a 30% Tax rate. removed this tax year.
953-964	Tax Liability Tier Two 30% Rate	12	Enter the tax liability for the Tier Tw Oil, subject to a 30% Tax rate, removed this tax year.
965-976	Number of Barrels Tier Three Newly Discovered	12	Enter the number of barrels of Tier Three Newly Discovered Oil removed this tax year.
977-988	Aggregate Value Tier Three [1] Newly Discovered	12	Enter the agregate removal value for the Tier Three Newly Discovered Oil removed this tax year.
989-1000	Adjusted Value Tier Three [1] Newly Discovered	12	Enter the aggregate adjusted base value for the Tier Three Newly Discovered Oil removed this tax year.
1001-1012	State Tax Adjustment Tier Three [1] Newly Discovered	12	Enter the aggregate state severence tax adjustment for the Tier Three Newly Discovered Oil removed this tax year.
1013-1024	Tax Liability Tier Three Newly Discovered	12	Enter the tax liability for the Tier Three Newly Discovered Oil removed this tax year.
1025-1036	Number of Barrels Tier Three Incremental	12	Enter the number of barrels of Tier Three Incremental Tertiar Oil removed this tax year.
1037-1048	Aggregate Value Tier Three [1] Incremental	12	Enter the aggregate removal value of the Tier Three Incrementa Tertiary Oil removed this tax year.
1049-1060	Adjusted Value Tier Three [1] Incremental	12	Enter the aggregate adjusted base value of the Tier Three Incre mental Tertiary Oil removed this tax year.
1061-1072	State Tax Adjustment Tier Three [1] Incremental	12	Enter the aggregate state severence tax adjustment for the Ti Three Incremental Tertiary Oil removed this tax year.

---

[1] These fields are optional under the regulations for filing for Tax Year '81, you are requested but not required to supply this information. These fiel correspond to Part III columns b, c and d, Form 6248.

RECORD NAME: PRODUCER/RECIPIENT "H" RECORD (continued)

Tape Position	Field Title	Length	Description and Remarks
1073-1084	Tax Liability Tier Three Incremental	12	Enter the tax liability for the Tier Three Incremental Tertiary Oil removed this tax year.
1085-1096	Number of Barrels Tier Three Heavy	12	Enter the number of barrels of Tier Three Heavy Oil removed this tax year.
1097-1108	Aggregate Value Tier Three [1] Heavy	12	Enter the aggregate removal value of the Tier Three Heavy Oil removed this tax year.
1109-1120	Adjusted Value Tier Three [1] Heavy	12	Enter the aggregate adjusted base value of the Tier Three Heavy Oil removed this tax year.
1121-1132	State Tax Adjustment Tier Three [1] Heavy	12	Enter the aggregate state severence tax adjustment for the Tier Three Heavy Oil removed this tax year.
1133-1144	Tax Liability of Tier Three Heavy	12	Enter the tax liability for the Tier Three Heavy Oil removed this tax year.
1145-1156	Total Barrels	12	Enter the total number of barrels removed this tax year for all classes of oil.
1157-1168	Total Tax Liability	12	Enter the total tax liability for all oil removed this tax year.
1169-1180	Tax Withheld Oil Removed This Tax Year	12	Enter the amount of Windfall Profit Tax withheld with respect to oil removed during the tax year.
1181-1192	Underwithheld Tax	12	Enter the amount of Windfall Profit Tax underwithheld, if any. If no underwithholding zero fill this field.
1193-1204	Overwithheld Tax	12	Enter the amount of Windfall Profit Tax overwithheld, if any. If no overwithholding zero fill this field.
1205-1216	WPT Withheld From Payments	12	Enter the amount of Windfall Profit Tax withheld from payments made during this tax year, regardless of when the liability for the tax arose.
1217-1219	Originator(s) of 1st Form 6248 Indicator	3	Enter the total number of originators for this Form (Right Justified and zero filled). If none, zero fill.
1220-1259	Originator's Name (Person furnishing Form 6248 information to payer/filer/first purchaser)	40	If the information on this Form 6248 is based on information from another Form 6248, enter the name of the person who furnished you with Form 6248. If present, left justify and blank fill. If not present, blank fill
1260-1268	Originator's TIN	9	If available, enter the TIN of the originator. If no data is entered, blank fill.
1269-1308	Second Originator's Name	40	If the information on this Form 6248 is based on information compiled from 2 or more Forms 6248, enter the name of the second person who furnished you with a Form 6248. If not present, blank fill.
1309-1317	Second Originator's TIN	9	If available, enter the TIN of the second originator. If no data is available, blank fill.
1318-1357	Third Originator's Name	40	If the information on this form is based on information compiled from 3 or more Forms 6248, enter the name of the third person who furnished you with a form 6248.

---

[1] These fields are optional under the regulations for filing for Tax Year '81, you are requested but not required to supply this information. These fields correspond to Part III columns b, c and d, Form 6248.

RECORD NAME: PRODUCER/RECIPIENT "H" RECORD (continued)

Tape Position	Field Title	Length	Description and Remarks
1358-1366	Third Originator's TIN	9	If available, enter the TIN of the third originator. If no data i available, blank fill.
1367-1372	Preparation Date	6	Optional. Enter the date of preparation of this form. If no present blank fill.
1373-1382	Owners I.D.	10	Optional. Enter up to 10 characters of data. Your accoun number for the owner/producer. If no data entered, blank fill.
1383-1450	Reserved	68	Reserved for IRS use. Blank fill.

SEC. 6. END OF FILER "I" RECORD

.01 The end of Filer "I" Record is a summary record for a given Filer. This record must be 1450 characters long.

.02 The "I" Record will contain the number of documents transmitted for each individual Filer. The "I" Record must be written after the last Producer "H" Record for each Filer. For each "G" Record on the file there must be a corresponding "I" Record.

.03 The "I" Record cannot be followed by a Tape Mark.

RECORD NAME: END OF FILER "I" RECORD

Tape Position	Field Title	Length	Description and Remarks
1	Record Type	1	Required. Enter "I".
2-7	Number of 6248's for This Filer	6	Required. Enter the number of "H" Records for this Filer. This volume should also be shown on Form 4804, Box 13.
8-47	Filer's Name	40	Enter the name of the Filer. Use the same name as shown on the Filer/Transmitter "G" Record.
48	Type of Account Filer's TIN	1	This position is used to identify the date in tape positions 49 thru 57 as either an EIN or SSN. Use one of the following codes as appropriate. 1) use the digit 0 if the number provided is an SSN. 2) use the digit 1 if the number provided is an EIN. 3) use the digit 2 if it is not known whether the number provided is an SSN or EIN. 4) use the digit 3 if no number is provided (positions 49-57 should be blank filled in this case).
49-57	Filer's Account Number	9	Required. Enter the Taxpayer Identifying Number of the Filer (SSN or EIN as appropriate). If no TIN is provided, leave blank.
58-69	Filer's Total Tax Liability	12	Enter the sum of the Filer's total tax liability (Part IV, Line 1). This amount should be shown on Form 4804, Box 16, Total Payment Amount for each Filer.
70-1450	Reserved		Reserved for IRS use. Blank fill to end of record.

SEC. 7. END OF REEL "J" RECORD

.01 The End of Reel "J" Record will be present for option 1 only. It must be 1450 characters long.

.02 Write this record when the end of the normal writing area of the reel has been reached, but all the records of the file have not been written. This record indicates that there are additional reels in the file.

.03 Each "J" Record must contain a count of Forms 6248 reported on all "H" Records not summarized in the preceding "I" Record on the Reel.

.04 If you do not wish to use a "J" Record, or your system is unable to generate it, you must delete it; however, the last "H" Record on the tape 'MUST' be followed by a Tape Mark.

RECORD NAME: END OF REEL "J" RECORD

Tape Position	Field Title	Length	Description and Remarks
1	Record Type	1	Required. Enter "J".
2-7	Number of 6248's	6	Enter the number of "H" Records not summarized in a previous "I" Record.
8-30	Zero Filled Field	23	Reserved. Fill with zeros.
31-1450	Reserved		Reserved for IRS use. Blank fill.

SEC. 8. END OF TRANSMISSION "K" RECORD

.01 The "K" Record is a summary of the number of Filers and the number of tapes in the entire file.
.02 This record should be written after the last "I" Record in the file.
.03 Only a Tape Mark or a Tape Mark and Trailer Labels may follow the "K" Record.
.04 The "K" Record must be 1450 characters long.

RECORD NAME: END OF TRANSMISSION "K" RECORD

Tape Position	Field Title	Length	Description and Remarks
1	Record Type	1	Required. Enter "K".
2-5	Number of Filers	4	Required. Enter the number of Filers in the transmission. Right justify and zero fill.
6-8	Number of Tapes	3	Required. Enter the total number of tapes in the transmission. Right justify and zero fill.
9-30	Reserved	23	Required. Enter zeros.
31-1450	Reserved		Enter blanks.

SEC. 9. TAPE LAYOUTS-OPTION 1

(Reel Sequence Number is in the "G" Record)

The following chart shows, by type of file, the record types to be used in the first two and the last three records to be written on a tape.

Type of File	1st record type	2nd record type	2nd from last record type	Next to last record type	Last record type
Single Filer, single reels	G	H	H	I	K
Single Filer, multiple reels:					
Reel 1	G	H	H	H	J(TM)[1]
Last Reel	G	H	H	I[2]	K
Multiple Filers, single reel:					
First Filer	G	H	H	H	I
Subsequent Filers	G	H	H	H	I
Final Filer	G	H	H	I	K
Multiple Filers, Multiple Reels: First Filer's records split between reel 1 and reel 2; Second Filer's records split between reel 2 and reel 3:					

---

[1] If your system can not produce the End of Reel "J" Record, the final "H" Record on an intermediate reel can be followed by a Tape Mark.
[2] Must contain the "Number of 6248's" summarizing all "H" Records on this and previous reels for this Filer, not summarized on a previous "I" record.

Reel 1:					
Filer 1	G	H	H	H	J(TM) [1]
Reel 2:					
Filer 1	G	H	H	H	I [2]
Filer 2	G	H	H	H	J(TM) [1]
Reel 3:					
Filer 2	G	H	H	H	I [2]
Filer 3	G	H	H	H	I
Reel 4: Last Filer	G	H	H	I	K
Multiple Filers, single transmitter, separate files for each filer:					
File 1: Filer 1: Last reel	G	H	H	I	K
File 2: Filer 2:					
Reel 1	G	H	H	H	J(TM) [1]
Last Reel	G	H	H	I [2]	K
File 3: Filer 3: Last reel	G	H	H	I	K

---

[1] If your system can not produce the End of Reel "J" Record, the final "H" Record on an intermediate reel can be followed by a Tape Mark.

[2] Must contain the "Number of 6248's" summarizing all "H" Records on this and previous reels for this Filer, not summarized on a previous "I" record.

SEC. 10. TAPE LAYOUTS-OPTION 2

(Reel Sequence Number is in the Header Label)

Where the Header Label is the first record, the following chart shows, by type of file, the record types to be used in the 2nd and 3rd records, where the header label is the first record, and the last three records written on a tape reel prior to the Trailer label.

Type of File	2nd record type	3rd record type	2nd from last record type	Next to last record type	Last record type
Single Filer, single reel	G	H	H	I	K
Single Filer, multiple reels:					
First Reel	G	H	H	H	H
Last Reel	H	H	H	I [1]	K
Multiple Filers, single reel:					
First Filer	G	H	H	H	I
Subsequent Filers	G	H	H	H	I
Final Filer	G	H	H	I	K
Multiple Filers, multiple reels; first Filer's records split between reel 1 and reel 2; second Filer's records split between reel 2 and reel 3:					
Reel 1:					
Filer 1	G	H	H	H	H
Reel 2:					
Payer 1	H	H	H	H	I [1]
Payer 2	G	H	H	H	H
Reel 3:					
Payer 2	H	H	H	H	I [1]
Payer 3	G	H	H	H	I
Reel 4:					
Payer 4	G	H	H	I	K
Multiple Filers, single Transmitter, separate files for each Filer:					
File 1: Filer 1: Last reel (could be multiple reel)	H	H	H	I [1]	K
File 2: Filer 2:					
Reel 1	G	H	H	H	H
Last Reel	H	H	H	I [1]	K

---

[1] Must contain the "Number of 6248's" summarizing all "H" Records on this and previous reels for this Filer not summarized in a previous "I" record.

SEC. 11: EFFECT ON OTHER DOCUMENTS

Rev. Proc. 81-13 is superseded.

26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 82-11

SECTION 1. BACKGROUND

Rev. Proc. 81-10, 1981-1 C.B. 647, sets forth areas in which rulings and determination letters will not be issued by the Internal Revenue Service. Section 3 of Rev. Proc. 81-10 lists areas in which rulings or determination letters will not be issued under any circumstances.

SEC. 2. PROCEDURE

Rev. Proc. 81-10 is amplified by adding to section 3 the following:

Section 2055—Transfers for Public, Charitable and Religious Uses.—Whether a charitable lead interest qualifies as a guaranteed annuity interest for purposes of section 2055(e)(2)(B) of the Code if that interest may be prepaid before the expiration of the specified term of that interest or before the death of the life or lives used to measure the term of such interest.

Section 2522—Charitable and Similar Gifts.—Whether a charitable lead interest qualifies as a guaranteed annuity interest for purposes of section 2522(c)(2)(B) of the Code if that interest may be prepaid before the expiration of the specified term of that interest or before the death of the life or lives used to measure the term of such interest.

Section 170—Charitable, Etc., Contributions and Gifts.—Whether a charitable lead interest qualifies as a guaranteed annuity interest for purposes of section 170(f)(2)(B) of the Code if that interest may be prepaid before the expiration of the specified term of that interest or before the death of the life or lives used to measure the term of such interest.

SEC. 3. EFFECTIVE DATE

This revenue procedure will apply to all ruling requests on hand in the National Office on February 22, 1982, the date of publication of this revenue procedure in the Internal Revenue Bulletin, as well as to requests received thereafter.

SEC. 4. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 81-10 is amplified.

---

26 CFR 601.602: Forms and instructions. (Also Part I, Sections 6011, 6041, 6047, 6051, 6071, 6081, 6091; 1.6041-1, 1.6047-1, 31.6051-1, 31.6051-2, 31.6071(a)-1, 31.6081(a)-1.)

Rev. Proc. 82-12

SECTION 1. PURPOSE

.01 The purpose of this revenue procedure is to state the requirements of the Internal Revenue Service (IRS) and the Social Security Administration (SSA) relating to substitutes for Form W-2, Wage and Tax Statement, Form W-2P, Statement for Recipients of Periodic Annuities, Pensions, Retired Pay or IRA Payments, and Form W-3, Transmittal of Income and Tax Statements (hereinafter referred to as Forms W-2, W-2P, and W-3). The IRS provides two Form W-2 sets, a six part and a four part. The official Form W-2P is provided as a six part set. The official Form W-3 is provided as a two part set.

.02 This revenue procedure supersedes Rev. Proc. 81-15, 1981-1 C.B. 670.

SEC. 2. GENERAL RULES FOR FILING FORMS W-2 AND W-2P

.01 *Employers and payers* (hereafter and where applicable collectively referred to as payers) with computer capability are encouraged to use magnetic media for filing Forms W-2 (Copy A) and W-2P (Copy A) with the SSA. Requests for additional information concerning magnetic media filing should be directed to either the Regional IRS Magnetic Media Coordinator or to the Regional SSA Magnetic Media Coordinator. Since many states and localities accept Forms W-2 and W-2P on magnetic media, savings may be obtained if a similar medium is used for filing with both the SSA and state or local agencies. Magnetic media users can design their own statements to give to employees, pensioners, annuitants, recipients of retired pay, recipients of IRA (Individual Retirement Account) payments, and recipients of disability income (hereafter and where applicable collectively referred to as payees). Statements designed by payers *must* comply with the requirements of Section 5 below.

.02 The following Technical Information Bulletins (TIB) contain the specifications and procedures for filing Forms W-2 (Copy A) and W-2P (Copy A) data on magnetic media directly with SSA.

1 TIB-4a—Magnetic Tape Reporting, "Submitting Wage and Tax Data to Federal and State Agencies" Form W-2 (Copy A);

2 TIB-4b—Magnetic Tape Reporting, "Submitting Annuity, Pension, Retired Pay or IRA Payments to the Federal Government on Magnetic Tape" Form W-2P (Copy A);

3 TIB-4c—Diskette Reporting, "Submitting Wage and Tax Data to the Federal Government on Diskette" Form W-2 (Copy A).

Copies of these publications are available at any IRS Service Center; IRS District Office; and SSA, (Reports Preparation Section, P.O. Box 2317, Baltimore, Maryland 21203); or by contacting the Regional SSA Magnetic Media Coordinator.

.03 Payers not using magnetic media must file Copy A of Form W-2 or Copy A of Form W-2P with SSA on either an official form or a privately printed substitute paper form meeting the specifications shown below.

.04 Payers using magnetic media are cautioned to obtain the most recent Technical Information Bulletins and supplements due to possible changes in the specifications and procedures.

SEC. 3. GENERAL RULES FOR FILING FORM W-3

.01 Employers and payers (hereafter and where applicable collectively referred to as payers) required to file Forms W-2 or W-2P *must* transmit Forms W-2 or W-2P with Form W-3.

.02 Form W-3 must be the same width (i.e., 7 inches, 7.5 inches, or 8 inches) as the Forms W-2 or W-2P filed.

.03 Payers using magnetic media

must transmit magnetic media Forms W-2 or W-2P with Form 6559, Transmittal Report of Magnetic Media Filing, along with either Form 6560, Employer Summary of Form W-2 Magnetic Media, or Form 6561, Payer Summary of Form W-2P Magnetic Media Pension Information. SSA will provide these forms to all approved magnetic media filers.

SEC. 4. PAPER SUBSTITUTES FOR FORMS W-2 (COPY A), W-2P (COPY A), AND W-3

.01 Paper substitutes conforming to the specifications contained in this revenue procedure may be privately printed without the prior approval of the IRS. Proposed substitutes not conforming totally to these specifications *must* be submitted by letter to the Commissioner of the IRS, Attention: TX:R:I, 1111 Constitution Ave., N.W., Washington, DC 20224, for consideration. These requests should contain an explanation of the specific need for the deviations and the number of Forms W-2, W-2P, and/or W-3 to be printed.

.02 Forms W-2, W-2P, and W-3 are subject to annual review and possible change. Payers are cautioned against overstocking supplies of privately printed substitutes.

.03 Copies of the official form for the reporting year may be obtained from IRS offices. The IRS provides only cut sheet sets with no carbon interleaves for Forms W-2, W-2P, and W-3.

.04 Substitute Forms W-2, W-2P, and W-3 transmitted to the SSA should generally contain only data provided to payees and summary data as requested by the form's instructions.

.05 Substitute Forms W-2, W-2P, and W-3 may be redesigned as to the spacing for state and local tax data *as long* as the vertical and horizontal spacing for all federal payment and data boxes are in compliance with the specifications contained herein.

.06 The sizes for the ballot boxes on all Forms W-2 (Copy A), W-2P (Copy A), and W-3 are as follows:

1 For Forms W-2, ballot boxes must be 8-point boxes.

2 For Forms W-2P, ballot boxes must be 8-point boxes.

3 For Forms W-3, ballot boxes must be 8-point boxes.

NOTE: More than 50% of the applicable ballot box must be covered by an "X".

SEC. 5. REQUIREMENTS FOR SUBSTITUTE FORMS FURNISHED TO PAYEES (COPIES B, C, AND 2 OF THE OFFICIAL SIX PART SET OF FORMS W-2 AND W-2P)

.01 All payers, including those filing Copy A using magnetic media, must furnish payees with at least two statements. The dimensions of these copies may be expanded from the dimensions of the official form to allow space for conveying additional information such as withholding from pay for health insurance, union dues, bonds, charity, etc. This may permit the payer to eliminate other statements or notices which would otherwise be furnished to payees. The maximum allowable dimensions are:

1 depth should be no more than five inches;

2 width no more than eight inches.

.02 The paper for all copies should be white. The substitute Copy B (or its equal), that payees are instructed to attach to their Federal income tax return, must be at least 24-pound paper (basis 17 x 22-1000), while the other copies furnished the payee should be at least 18-pound paper (basis 17 x 22-1000).

.03 Chemical transfer paper is *permitted* only if the following standards are met:

1 All copies must be clearly legible;

2 All copies must have the capability to be photocopied;

3 Fading must not be of such a degree as to preclude legibility and the ability to photocopy.

In general, black chemical transfer inks are preferred; other colors are permitted only if the above standards are met. "Spot carbons" are *not permitted*.

.04 Interleaved carbon must meet the requirements specified in .03 above.

NOTE: Chemical transfer paper is permitted for additional payee copies.

.05 Substitute forms for payees need contain only the payment boxes and captions that are applicable (in any desired sequence). Other boxes contained on the official form may be omitted, except that in all cases the payee name, address and social security number must be present. Payment boxes and captions that are applicable must be clearly identified, using where possible the same wording as on the official form. If the form contains additional data (e.g., savings bonds withholding, retirement withholding, payroll savings, etc.), there should be a special highlighting of the areas pertaining to (1) Federal income tax withheld, (2) Wages, tips, and other compensation, and (3) Advance EIC payment.

.06 For substitute forms for payees (Copies B, C, and 2 of Forms W-2 and Copies B, C, and 2 of Forms W-2P), the following requirements must be met:

1 All copies of Forms W-2 and W-2P *must* contain the form title. For Form W-2, the title is "Form W-2 Wage and Tax Statement". For Form W-2P, the title is "Form W-2P Statement for Recipients of Periodic Annuities, Pensions, Retired Pay, or IRA Payments". Note: The title "Form W-2" or "Form W-2P" does not appear on Copy 2.

2 If the substitute forms are *not labelled* as to the disposition of the copies, then written notification must be provided to each payee as specified below:

(a) The first copy of the form must be filed with the employee's (or recipient's) Federal tax return.

(b) The second copy of the form is for the employee's (or recipient's) records.

(c) If applicable, the third copy of the form should be filed with the employee's State, City, or Local income tax return.

3 If the substitute forms are *labelled*, then the forms must contain the applicable description:

(a) "Copy B, to be filed with employee's Federal tax return", "Copy C, for employee's records", and the designation "Form W-2 Department of the Treasury—Internal Revenue Service", or

(b) "Copy B, file with recipient's Federal tax return", "Copy C, for recipient's records", and the designation "Form W-2P Department of the

Treasury—Internal Revenue Service".

(c) The form number and reference to the Department of the Treasury—Internal Revenue Service should be omitted from other copies provided in the set.

4 Instructions similar to those contained on the back of Copy C of the official form should be provided to each employee (recipient). For Form W-2, the social security (FICA) rates applicable for the current tax year must:

(a) appear either on the front or the back of the copy (Copy C) retained by the employee; or

(b) be communicated to the employee via a separate statement.

The IRS recommends that the other text on the back of the official form Copy C be provided to the employee.

5 Such substitutes are acceptable and payees should be advised that substitute wage and tax statements are acceptable for filing with their Federal income tax returns.

SEC. 6. REQUIREMENTS FOR SUBSTITUTE "PRIVATELY PRINTED" FORMS W-2 (COPY A), FORMS W-2P (COPY A), AND FORMS W-3 THAT PAYERS SUBMIT TO THE SSA

.01 Payers may file privately printed substitute Forms W-2 and W-2P with the SSA (hereafter referred to as a substitute Copy A). Payers may file privately printed substitute Forms W-3 with the SSA (hereafter referred to as a substitute W-3). The substitute form must be an exact replica of the official repro-proof with respect to layout and contents. Chemical transfer paper and "spot carbons" are *not permitted* for Copy A or for Form W-3 filed with SSA. The dimensions of a substitute form may differ as far as width (see Section 6.05 below) and the printing of the Government Printing Office (GPO) symbol must be deleted (see Section 6.12 below). The specifications and allowable tolerances for the Copy A of substitute Forms W-2 and W-2P are provided in Exhibits A, B, C, E, F, G, and H respectively. The specifications and allowable tolerances for Forms W-3 are provided in Exhibits D, I, and J.

NOTE: *Printers of Forms W-2 or W-2P that are wider than 7 inches must provide Forms W-3 that are of the same width as the Forms W-2 or W-2P (i.e., 7½" width Forms W-3 with 7½" width Forms W-2 and W-2P; 8" width Forms W-3 with 8" width Forms W-2 and W-2P).*

.02 Color and quality of paper.

Paper for Copy A and for Form W-3, (cut sheets and continuous pinfeed forms), to be filed with SSA, as specified by JCP 0-25, dated November 29, 1978, must be: White 100% bleached chemical wood, optical character recognition (OCR) bond produced in accordance with the following specifications:

NOTE: Reclaimed fiber in any percentage is permitted, provided the requirements of this standard are met.

1 Acidity: pH value, average,
   not less than 4.5
   Bond
2 Basis Weight 17 x 22
   1000 cut sheets 40
   Metric equivalent—g/m2 75
   A Tolerance of ± 5 pct. shall be allowed.
3 Stiffness: Average, each direction, not less
   than—milligrams 50
4 Tearing strength: Average, each direction, not less
   than—grams 40
5 Opacity: Average, not less
   than—percent 82
6 Thickness: Average—
   inch__0.0038
   Metric equivalent—
   mm__0.097
   A tolerance of ± 0.0005 inch (0.0127 mm) shall be allowed.
   Paper shall not vary more than 0.0004 inch (0.0102 mm) from one edge to the other.
7 Porosity: Average, not less
   than—seconds 10
8 Finish (smoothness): Average,
   each side—seconds 20-55
   For information only, the Sheffield
   equivalent—units 170-100
9 Dirt: Average, each side, not to exceed—parts
   per million 8

.03 All printing will be in red OCR dropout ink, as specified below, except for the '22222', '55555', or '33333' at the top of the form and the descriptive information at the bottom (see Exhibits K, L, M, and N) which will be printed in nonreflective black ink. All other printing will be in red OCR dropout ink with or comparable to the specifications below. The screened area of any substitute form (Copy A of Form W-2 and W-2P, and the Form W-3 that is sent to SSA) should generally correspond to that present on the official form. Vertical rules require screening of .05 inches on each side of an inside rule. Horizontal screening should follow the standard format and allow for typewriter spacing. All screened areas are to be printed in the red OCR dropout ink. The numbered captions are printed as a solid with no screened background. (See Exhibits) Printing in red OCR dropout ink other than those listed below must be cleared by contacting: Manager of Media Support, Recognition Equipment, Inc., P.O. Box 222307, Dallas, Texas 75222; telephone number 214-438-8611, extension 1416. The red OCR dropout ink specifications already approved by Recognition Equipment, Inc., are:

Ink Manufacturer	*Red Ink Identification No.*
Gans Ink Co.	CS-310
General Printing Inks Div. (Sun Chemical Corp.)	SS-40B
Ink Masters, Inc. (Chicago)	B-6056
Inmont Canada, Ltd.	4T-39605
Lorilleux Lefranc	U-17410
Sinclair & Valentine (U.S.)	J-24893
Toyo Ink Company	OMR-57

.04 Typography—Type must be substantially identical in size and shape with corresponding type on the official form. NOTE: The form identifying number must be in OCR A font.

1 On Copy A of Forms W-2 and W-2P and for Form W-3, all the perimeter rules must be 1-point (0.014 inch), while all other rules must be one-half point (0.007 inch).

2 Vertical rules must be parallel to the left edge of the document; horizontal rules parallel to the top edge.

.05 Dimension—Three official Forms W-2, W-2P (Copy A) or one official Form W-3 are contained on a single page which is 7 inches wide (exclusive of any snap-stubs) by 11 inches deep. The width of privately printed substitute pages must be 7 inches. 7¼ inches, or 8 inches exclusive of any left or right snap-stubs, or pin-feed holes, although adherence to the size of the official page is preferred. If a 7 inch form is produced, the image must be an exact copy of the official repro-proof. If the width of the substitute page is increased, the width of specified fields on the substitute page must be increased in accordance with Exhibits E, F, G, H, I, and J. The top margins and the right margin must be ¼ inch plus or minus .0313 inch and must be free of all printing. For Forms W-2, the combination width of Box 1, "Control number", and the box containing the Form Identifying Number must always be 2.2 inches. For Forms W-2P and W-3, the combination width of Box 1, "Control Number", and the box containing the Form Identifying Number must always be 2.15 inches.

1 When the width of Copy A is increased to 8 inches, exclusive of any left or right snap-stubs or pin-feed holes, the form identifying number must be shown as 222 for Form W-2, 555 for Form W-2P, or 333 for Form W-3. This number tells the scan equipment used by SSA which information document it is reading, the width size and the position of individual data fields (see Exhibits E, G, and I).

2 When the width of Copy A is increased to 7½ inches, exclusive of any left or right snap-stubs or pin-feed holes, the form identifying number must be shown as 2222 for Form W-2, 5555 for Form W-2P, or 3333 for Form W-3. This number tells the scan equipment used by the SSA which information document it is reading, the width size and the position of individual data fields (see Exhibits F, H, and J).

.06 The depth of the individual image on a page (for Form W-2 and W-2P) must be the same (3⅔ inches) as that of the official repro proof. The depth of the Form W-3 on a page must be 3.37 inches.

.07 The words "*Do Not Cut or Separate Forms on This Page*" must be printed in red OCR dropout ink between the three Forms W-2 or W-2P (Copy A) (see Exhibits A, B, and C) and *must* also be present on 7½ inch and 8 inch wide substitute Forms W-2 or W-2P. Perforations are required on all copies (except Copy A) to enable the separation of individual forms.

.08 The words "For Paperwork Reduction Act Notice, see back of Copy D" *must* be printed on the Forms W-2 or W-2P (Copy A) (see Exhibits A, B, and C for format and location) and *must* also be present on 7½ inch and 8 inch wide substitute Forms W-2 or W-2P.

.09 The OMB Number *must* be printed on *each* ply of Form W-2, W-2P, and W-3 (see Exhibits A, B, C, and D for format and location) and *must* also be present on 7½ inch and 8 inch wide substitute Forms W-2, W-2P, or W-3.

.10 The words "*Please return this entire page to the Social Security Administration address for your State as listed below*" as well as the list of SSA addresses *must* be printed on all Forms W-3 (see Exhibit D) whether Forms W-3 are 7 inches wide, 7½ inches wide, or 8 inches wide.

.11 The Paperwork Reduction Act Notice must be printed on Form W-3 (see Exhibit D for format and location) whether Forms W-3 are 7 inches wide, 7½ inches wide, or 8 inches wide.

.12 *Privately printed continuous substitute Forms W-2 and W-2P (Copy A) must be perforated at each 11" (3-on) page depth. No perforations are allowed between the 3⅔" forms on a single copy page of Copy A.*

NOTE: Perforations are required between all the other individual copies (Copy 1, B, C, 2, and D) included in the set.

.13 The back of a substitute Copy A must be free of all printing.

.14 Carbonized. "*Chemical transfer paper*" and "*spot carbons*" are *not permitted* for Copy A of Forms W-2 or W-2P or for Form W-3. Interleaved carbon must be of good quality to assure legibility of information on all parts to preclude smudging, and should be black (see Section 5.04).

.15 Printer's symbol—The GPO symbol must not be placed on substitute Copy A of Forms W-2 and W-2P. In the place of the GPO symbol, the Employer Identification Number (EIN) of the forms printer must be printed in the bottom margin on the face of each individual sheet of Copy A. In addition, the EIN of the forms printer *must be printed on the face* of the Form W-3 which is filed with SSA.

.16 All printers of substitute or privately printed Forms W-2, W-2P, or W-3 are requested to provide 3 copies of each version of each form to SSA, P.O. Box 2317, Baltimore, Maryland 21235. Paper substitutes conforming to the specifications contained in this procedure may be sent to SSA directly. Paper substitutes requiring IRS consideration and approval should be sent to SSA *only* after IRS approval has been granted.

SEC. 7. ADDITIONAL INSTRUCTIONS

.01 Arrangement of assembly—Except as provided below, if magnetic media is not used for filing with SSA, the substitute copies of Forms W-2 and W-2P assembly should be arranged in the same order as the official Forms W-2 and W-2P. Copy A first, followed sequentially by perforated sets (Copies 1, B, C, 2, and D). The substitute form to be filed with SSA by the payer must carry the designation Copy A.

1 Copy D for Employer or Payer. It is not required that privately printed substitute forms contain a copy to be retained by payers although payers must be prepared to verify or duplicate this information if it is requested by the IRS or SSA.

(a) If Copy D *is provided* for the employer or payer, instructions contained on the back of Copy D of the official form *must* appear on the back of the substitute form Copy D.

(b) If Copy D *is not provided* for the employer or payer, instructions contained on the back of Copy D of the official form *must* be furnished on a separate statement to the employer or payer.

2 Additional Copies. Except as provided in the arrangement of the official assemblies, additional copies which may be prepared by payers shall not be placed ahead of the copy "For employee's records," Copy C (Forms W-2) or "For Recipient's Records," Copy C (Form W-2P).

3 Notice to Employees. Instructions similar to those contained on the back of Copy C of the official form should be provided to each employee (recipient). For Form W-2, the social security

(FICA) rates applicable for the current tax year must:

(a) appear either on the front or the back of the copy (Copy C) retained by the employee; or

(b) be communicated to the employee via a separate statement.

The IRS recommends that the other text on the back of the official form Copy C be provided to the employee.

.03 All privately printed Forms W-2 and W-2P (Copy A) must have the tax year printed on the bottom face of each, using identical type to that of the official format.

.04 The substitute Copy B (or its equal), which the payee is instructed to attach to his/her Federal income tax return, *must* be at least 24-pound paper (basis 17 x 22-1000), while the other copies furnished the payee should be at least 18-pound paper (basis 17 x 22-1000).

.05 The OCR bond Form W-3 that is filed with SSA *must* have *no* printing on the reverse side.

.06 Instructions for Form W-3—Instructions similar to those provided as part of the official form *must* be provided as part of any substitute Form W-3.

.07 All privately printed Forms W-3 *must* have the tax year printed on the bottom face of each Form W-3, using identical type to that of the official format.

.08 The copy of the substitute Form W-3 which contains the instructions and is to be retained by the employer should be at least 18-pound paper (basis 17 x 22-1000).

SEC. 8. INSTRUCTIONS FOR PAYERS

.01 Only originals or ribbon copies of Copy A of Forms W-2 and W-2P and of Form W-3 may be filed. Carbon copies and photocopies are *not* acceptable.

.02 The Service requests the cooperation of the payers in typing or machine printing whenever possible and in providing good quality data entries on the forms, i.e., using black ribbon, inserting data in the middle of blocks, well separated from other printing and guidelines, and taking any other measures that will guarantee clear, sharp images. However, payers are not required to acquire equipment solely for the purpose of preparing these forms.

.03 The Employer Identification Number (EIN) may be entered anywhere in Box 2 along with the Payer's name and address on Copy A of Forms W-2 and W-2P. (If this is done, the EIN need not be entered in Box 3 of either Form W-2 or W-2P.) For Forms W-3, the EIN must be entered where prescribed by the Form W-3 Instructions.

.04 The payer's name, address and EIN may be pre-printed.

.05 State agencies—The amounts of wages paid and employee contributions withheld under a State-Federal Agreement, entered into pursuant to Section 218 of the Social Security Act, may be shown in the space on Form W-2 for Federal Insurance Contribution Act Wages and Employee Tax. In such cases, the identification number assigned by the Social Security Administration to the state (prefixed by 69) should be shown in the employer name and address area block on Form W-2. This "69" number may be pre-printed. For Form W-3, the identification number must be entered where prescribed by the Form W-3 instructions.

.06 The optional employer's state number may be pre-printed in the employer's (payer's) name, address, and ZIP code box. If this is done, Box 4 of Forms W-2 and W-2P need not be completed, so long as the applicable state taxing authority does not object.

.07 The preparation and filing instructions for Forms W-2 and W-2P are contained in the 1982 Instructions for Forms W-2 and W-2P. The preparation and filing instructions for Form W-3 are contained as part of the 1982 Form W-3 snap set assembly.

.08 To avoid confusion and questions by payees, payers are encouraged to delete the following items from copies of Forms W-2 and W-2P provided to payees:

(1) Form identifying number (e.g., 22222, 55555);

(2) The words "subtotal" and "void" and their boxes;

(3) Any other captions or box number that would *not* be of any informational use to payees.

.09 Payers are encouraged to use IRS-supplied labels for affixing to all Forms W-3 filed with SSA.

SEC. 9. OMB REQUIREMENTS

Office of Management and Budget (OMB) Requirements for Substitute Forms

Public Law 96-511 requires: (1) OMB approval of IRS tax forms, (2) that each form (all copies) show the OMB approval number and, when appropriate, the form's expiration date, (3) the form (or it's instructions) state why IRS is collecting the information, how we will use it and whether it must be given to us. The official IRS forms will contain this information.

As it applies to substitute IRS forms this means:

1. All substitute forms (all copies) *must* show the OMB number and any expiration date as they appear on the official IRS form (see Exhibits A, B, C, and D).

2. The OMB number (and date) must use one of the following formats:

a. OMB No. XXXX-XXXX
(preferred)
or
OMB # XXXX-XXXX
b. OMB No. XXXX-XXXX
(preferred)
Expires XXXXXX
(mmddyy)
or
OMB # XXXX-XXXX
(preferred)
Expires XXXXXX
(mmddyy)
c. OMB No. XXXX-XXXX
Expires XXXXXX
(mmddyy) (preferred)
or
OMB # XXXX-XXXX
Expires XXXXXX
(mmddyy)

3. You must inform the users of your substitute forms of the reasons for IRS collection, use and requirements, as stated in the instructions for the IRS form.

4. The official OMB approval numbers (and expiration date) may be obtained from reproduction proofs, official IRS printed forms, or when approval is requested for a substitute form.

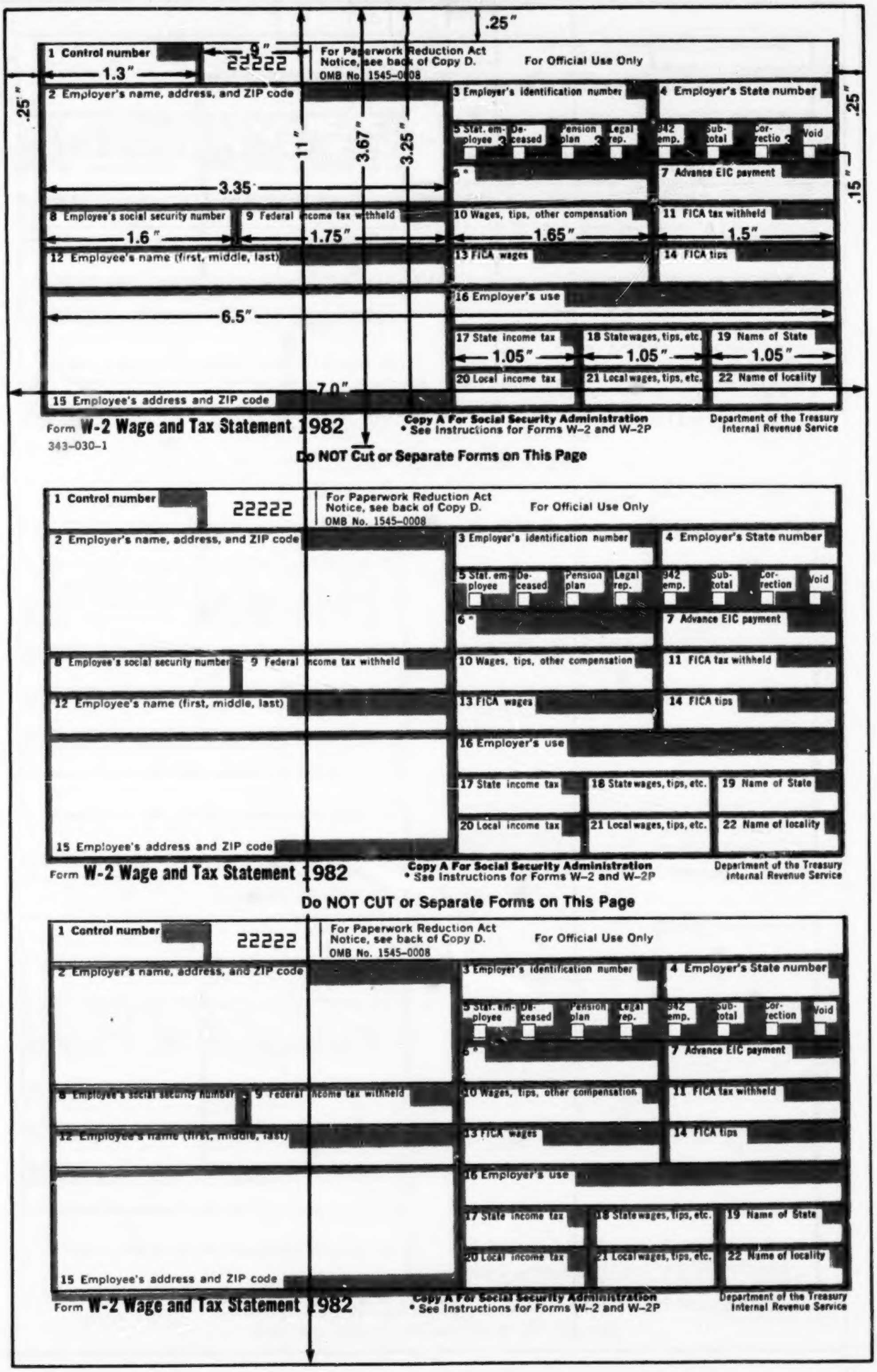
SEC. 10. REPRODUCTION PROOF

Order blanks for reproduction proofs are mailed annually to requestors of record, and on request to other users. Reproduction copies of Forms W-2 (Copy A), W-2P (Copy A), and W-3 (Page 1) each consists of two parts. Part 1 is line art, i.e., type and ink. Part 2 is a black solid which should be photographically screened by the user to allow a 10%-20% dot pattern when printed in red OCR dropout ink. In some cases where the production method requires the use of something other than a standard dot pattern, the printed value of part 2 must still be 10%-20%. Printers and others wishing to obtain reproduction proofs may send their requests to the Commissioner of IRS, Attention: RM:FM:P, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. A charge of $1 per page will be made for each reproduction proof regardless of page size. Invoices will be mailed after orders have been filled.

SEC. 11. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 81-15 is superseded.

Exhibit A Form W-2 (6 part)



1 Control number	22222	For Paperwork Reduction Act Notice, see back of Copy D. OMB No. 1545-0008	For Official Use Only
2 Employer's name, address, and ZIP code		3 Employer's identification number	4 Employer's State number
		5 Stat. employee ☐ Deceased ☐ Pension plan ☐ Legal rep. ☐	942 emp. ☐ Subtotal ☐ Correction ☐ Void ☐
		6 *	7 Advance EIC payment
8 Employee's social security number	9 Federal income tax withheld	10 Wages, tips, other compensation	11 FICA tax withheld
12 Employee's name (first, middle, last)		13 FICA wages	14 FICA tips
		16 Employer's use	
		17 State income tax 18 State wages, tips, etc. 19 Name of State	
15 Employee's address and ZIP code		20 Local income tax 21 Local wages, tips, etc. 22 Name of locality	

Form **W-2 Wage and Tax Statement 1982**

Copy A For Social Security Administration
• See Instructions for Forms W-2 and W-2P

Department of the Treasury
Internal Revenue Service

343-030-1

Do NOT Cut or Separate Forms on This Page

1 Control number	22222	For Paperwork Reduction Act Notice, see back of Copy D. OMB No. 1545-0008	For Official Use Only
2 Employer's name, address, and ZIP code		3 Employer's identification number	4 Employer's State number
		5 Stat. employee ☐ Deceased ☐ Pension plan ☐ Legal rep. ☐	942 emp. ☐ Subtotal ☐ Correction ☐ Void ☐
		6 *	7 Advance EIC payment
8 Employee's social security number	9 Federal income tax withheld	10 Wages, tips, other compensation	11 FICA tax withheld
12 Employee's name (first, middle, last)		13 FICA wages	14 FICA tips
		16 Employer's use	
		17 State income tax 18 State wages, tips, etc. 19 Name of State	
15 Employee's address and ZIP code		20 Local income tax 21 Local wages, tips, etc. 22 Name of locality	

Form **W-2 Wage and Tax Statement 1982**

Copy A For Social Security Administration
• See Instructions for Forms W-2 and W-2P

Department of the Treasury
Internal Revenue Service

Do NOT CUT or Separate Forms on This Page

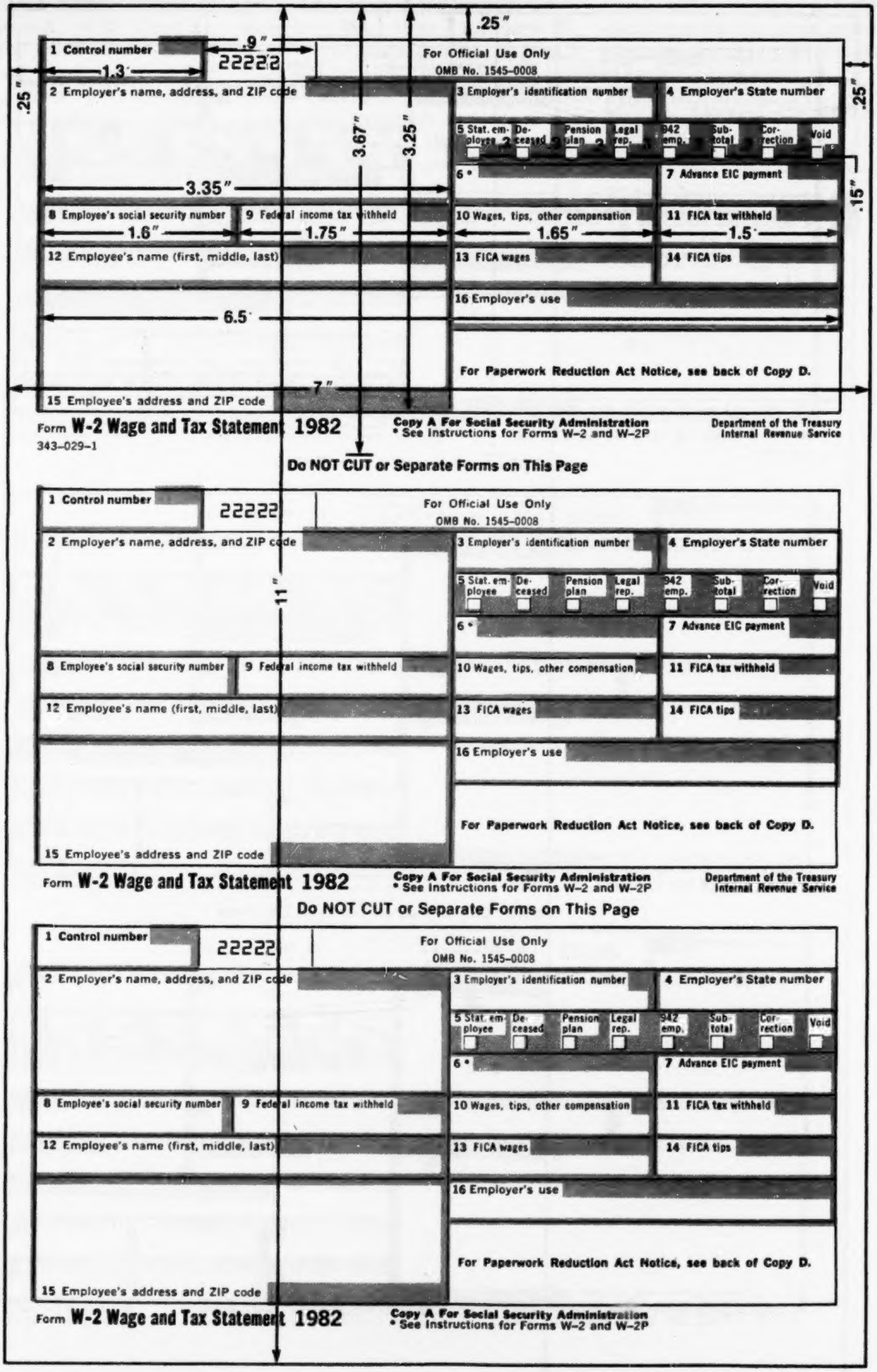
1 Control number	22222	For Paperwork Reduction Act Notice, see back of Copy D. OMB No. 1545-0008	For Official Use Only
2 Employer's name, address, and ZIP code		3 Employer's identification number	4 Employer's State number
		5 Stat. employee ☐ Deceased ☐ Pension plan ☐ Legal rep. ☐	942 emp. ☐ Subtotal ☐ Correction ☐ Void ☐
		6 *	7 Advance EIC payment
8 Employee's social security number	9 Federal income tax withheld	10 Wages, tips, other compensation	11 FICA tax withheld
12 Employee's name (first, middle, last)		13 FICA wages	14 FICA tips
		16 Employer's use	
		17 State income tax 18 State wages, tips, etc. 19 Name of State	
15 Employee's address and ZIP code		20 Local income tax 21 Local wages, tips, etc. 22 Name of locality	

Form **W-2 Wage and Tax Statement 1982**

Copy A For Social Security Administration
• See Instructions for Forms W-2 and W-2P

Department of the Treasury
Internal Revenue Service

Exhibit B Form W-2 (4 part)


.25"
.9"
1.3"
.25"
3.67"
3.25"
.25"
.15"
3.35"
1.6"
1.75"
1.65"
1.5
6.5
7"
11"

1 Control number
22222
For Official Use Only
OMB No. 1545-0008

2 Employer's name, address, and ZIP code

3 Employer's identification number

4 Employer's State number

5 Stat. employee ☐ Deceased ☐ Pension plan ☐ Legal rep. ☐ 942 emp. ☐ Sub-total ☐ Cor-rection ☐ Void ☐

6 *

7 Advance EIC payment

8 Employee's social security number

9 Federal income tax withheld

10 Wages, tips, other compensation

11 FICA tax withheld

12 Employee's name (first, middle, last)

13 FICA wages

14 FICA tips

16 Employer's use

For Paperwork Reduction Act Notice, see back of Copy D.

15 Employee's address and ZIP code

Form **W-2 Wage and Tax Statement 1982**

Copy A For Social Security Administration
* See Instructions for Forms W-2 and W-2P

Department of the Treasury
Internal Revenue Service

343-029-1

Do NOT CUT or Separate Forms on This Page

1 Control number
22222
For Official Use Only
OMB No. 1545-0008

2 Employer's name, address, and ZIP code

3 Employer's identification number

4 Employer's State number

5 Stat. employee ☐ Deceased ☐ Pension plan ☐ Legal rep. ☐ 942 emp. ☐ Sub-total ☐ Cor-rection ☐ Void ☐

6 *

7 Advance EIC payment

8 Employee's social security number

9 Federal income tax withheld

10 Wages, tips, other compensation

11 FICA tax withheld

12 Employee's name (first, middle, last)

13 FICA wages

14 FICA tips

16 Employer's use

For Paperwork Reduction Act Notice, see back of Copy D.

15 Employee's address and ZIP code

Form **W-2 Wage and Tax Statement 1982**

Copy A For Social Security Administration
* See Instructions for Forms W-2 and W-2P

Department of the Treasury
Internal Revenue Service

Do NOT CUT or Separate Forms on This Page

1 Control number
22222
For Official Use Only
OMB No. 1545-0008

2 Employer's name, address, and ZIP code

3 Employer's identification number

4 Employer's State number

5 Stat. employee ☐ Deceased ☐ Pension plan ☐ Legal rep. ☐ 942 emp. ☐ Sub-total ☐ Cor-rection ☐ Void ☐

6 *

7 Advance EIC payment

8 Employee's social security number

9 Federal income tax withheld

10 Wages, tips, other compensation

11 FICA tax withheld

12 Employee's name (first, middle, last)

13 FICA wages

14 FICA tips

16 Employer's use

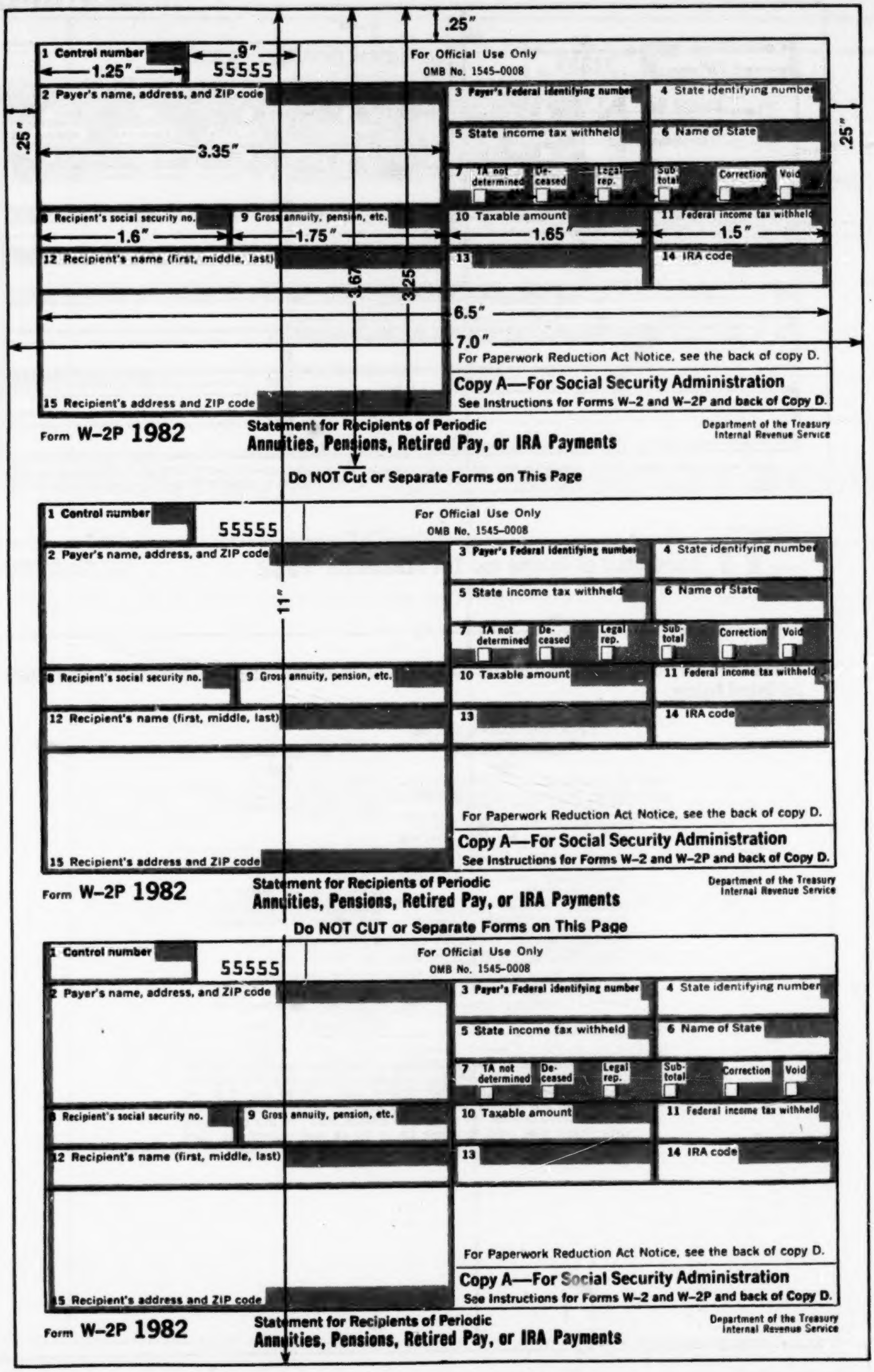
For Paperwork Reduction Act Notice, see back of Copy D.

15 Employee's address and ZIP code

Form **W-2 Wage and Tax Statement 1982**

Copy A For Social Security Administration
* See Instructions for Forms W-2 and W-2P

Exhibit C



1 Control number 55555

For Official Use Only
OMB No. 1545–0008

2 Payer's name, address, and ZIP code

3 Payer's Federal identifying number

4 State identifying number

5 State income tax withheld

6 Name of State

7 TA not determined ☐ De-ceased ☐ Legal rep. ☐ Sub-total ☐ Correction ☐ Void ☐

8 Recipient's social security no.

9 Gross annuity, pension, etc.

10 Taxable amount

11 Federal income tax withheld

12 Recipient's name (first, middle, last)

13

14 IRA code

15 Recipient's address and ZIP code

For Paperwork Reduction Act Notice, see the back of copy D.

Copy A—For Social Security Administration
See Instructions for Forms W-2 and W-2P and back of Copy D.

Form **W–2P 1982**

Statement for Recipients of Periodic Annuities, Pensions, Retired Pay, or IRA Payments

Department of the Treasury
Internal Revenue Service

Do NOT Cut or Separate Forms on This Page

1 Control number 55555

For Official Use Only
OMB No. 1545–0008

2 Payer's name, address, and ZIP code

3 Payer's Federal identifying number

4 State identifying number

5 State income tax withheld

6 Name of State

7 TA not determined ☐ De-ceased ☐ Legal rep. ☐ Sub-total ☐ Correction ☐ Void ☐

8 Recipient's social security no.

9 Gross annuity, pension, etc.

10 Taxable amount

11 Federal income tax withheld

12 Recipient's name (first, middle, last)

13

14 IRA code

15 Recipient's address and ZIP code

For Paperwork Reduction Act Notice, see the back of copy D.

Copy A—For Social Security Administration
See Instructions for Forms W-2 and W-2P and back of Copy D.

Form **W–2P 1982**

Statement for Recipients of Periodic Annuities, Pensions, Retired Pay, or IRA Payments

Department of the Treasury
Internal Revenue Service

Do NOT CUT or Separate Forms on This Page

1 Control number 55555

For Official Use Only
OMB No. 1545–0008

2 Payer's name, address, and ZIP code

3 Payer's Federal identifying number

4 State identifying number

5 State income tax withheld

6 Name of State

7 TA not determined ☐ De-ceased ☐ Legal rep. ☐ Sub-total ☐ Correction ☐ Void ☐

8 Recipient's social security no.

9 Gross annuity, pension, etc.

10 Taxable amount

11 Federal income tax withheld

12 Recipient's name (first, middle, last)

13

14 IRA code

15 Recipient's address and ZIP code

For Paperwork Reduction Act Notice, see the back of copy D.

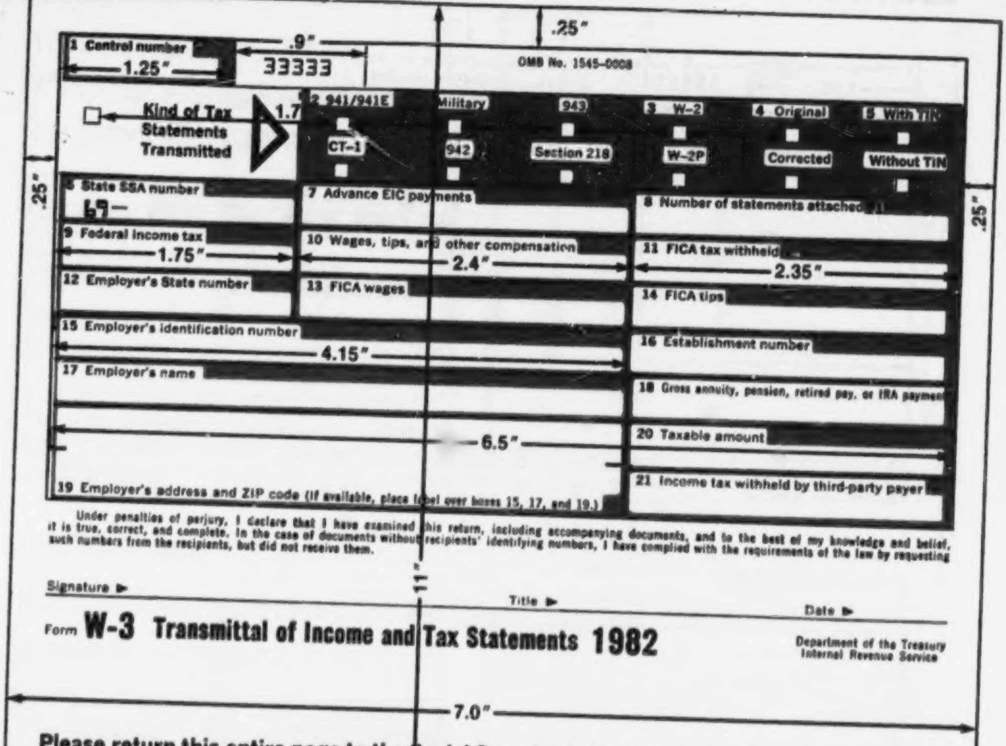
Copy A—For Social Security Administration
See Instructions for Forms W-2 and W-2P and back of Copy D.

Form **W–2P 1982**

Statement for Recipients of Periodic Annuities, Pensions, Retired Pay, or IRA Payments

Department of the Treasury
Internal Revenue Service

Exhibit D


.9"
.25"
1.25"
1.7
.25"
.25"
1.75"
2.4"
2.35"
4.15"
6.5"
11"
7.0"

1 Control number 33333

OMB No. 1545-0008

☐ Kind of Tax Statements Transmitted

2 941/941E ☐ Military ☐ 943 ☐ 3 W-2 ☐ 4 Original ☐ 5 With TIN ☐

CT-1 ☐ 942 ☐ Section 218 ☐ W-2P ☐ Corrected ☐ Without TIN ☐

6 State SSA number 69-

7 Advance EIC payments

8 Number of statements attached

9 Federal income tax

10 Wages, tips, and other compensation

11 FICA tax withheld

12 Employer's State number

13 FICA wages

14 FICA tips

15 Employer's identification number

16 Establishment number

17 Employer's name

18 Gross annuity, pension, retired pay, or IRA paymen

20 Taxable amount

19 Employer's address and ZIP code (If available, place label over boxes 15, 17, and 19.)

21 Income tax withheld by third-party payer

Under penalties of perjury, I declare that I have examined this return, including accompanying documents, and to the best of my knowledge and belief, it is true, correct, and complete. In the case of documents without recipients' identifying numbers, I have complied with the requirements of the law by requesting such numbers from the recipients, but did not receive them.

Signature ▶ Title ▶ Date ▶

Form **W-3** **Transmittal of Income and Tax Statements 1982**

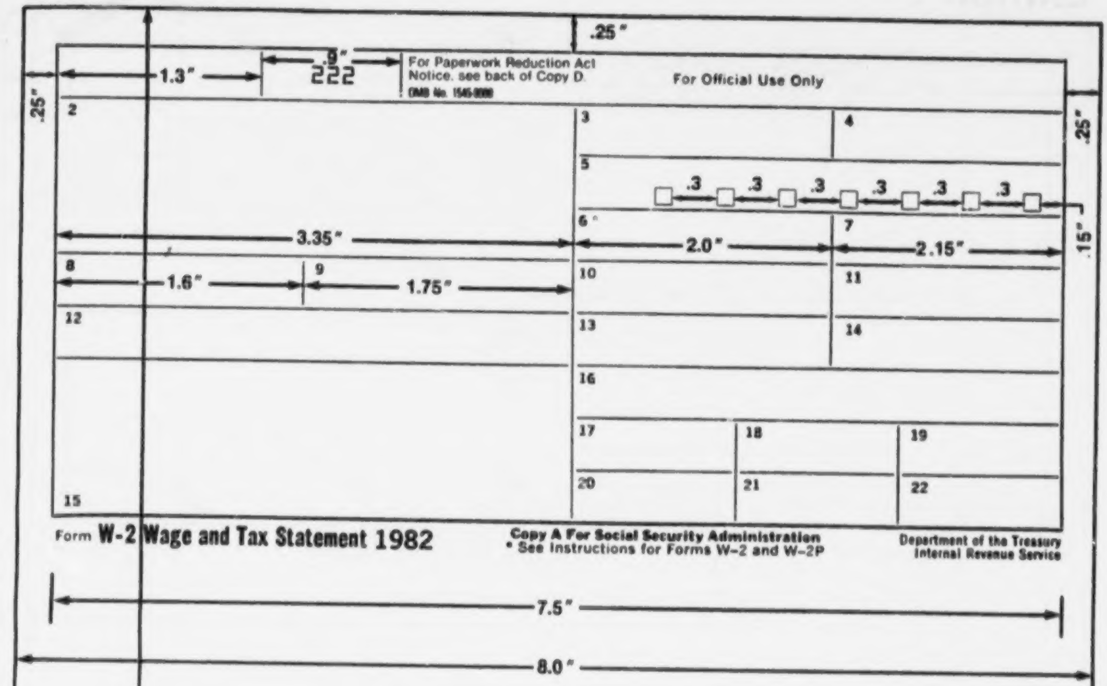
Department of the Treasury
Internal Revenue Service

Please return this entire page to the Social Security Administration address for your State as listed below.

If your legal residence, principal place of business, office or agency is located in ▼	Use this address ▼
Alaska, Arizona, California, Colorado, Hawaii, Idaho, Iowa, Minnesota, Missouri, Montana, Nebraska, Nevada, North Dakota, Oregon, South Dakota, Utah, Washington, Wisconsin, Wyoming	Social Security Administration Salinas Data Operations Center Salinas, CA 93911
Alabama, Arkansas, Florida, Georgia, Illinois, Kansas, Louisiana, Mississippi, New Mexico, Oklahoma, South Carolina, Tennessee, Texas	Social Security Administration Albuquerque Data Operations Center Albuquerque, NM 87180
Connecticut, Delaware, District of Columbia, Indiana, Kentucky, Maine, Maryland, Massachusetts, Michigan, New Hampshire, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Rhode Island, Vermont, Virginia, West Virginia	Social Security Administration Wilkes-Barre Data Operations Center Wilkes-Barre, PA 18769
If you have no legal residence or principal place of business in any State	Social Security Administration Wilkes-Barre Data Operations Center Wilkes-Barre, PA 18769

Paperwork Reduction Act Notice.—The Paperwork Reduction Act of 1980 says we must tell you why we are collecting this information, how we will use it, and whether you have to give it to us. We ask for the information to carry out the Internal Revenue laws of the United States. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax. You are required to give us this information.

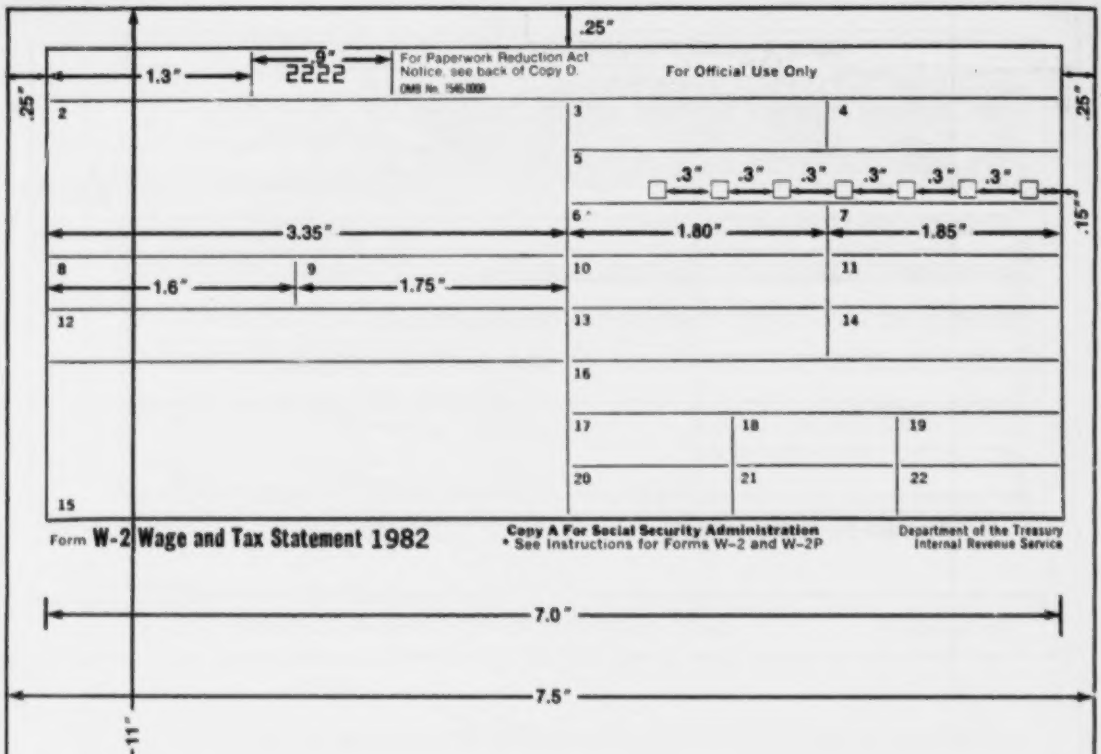
Exhibit E


.25"
1.3"
.9"
222
For Paperwork Reduction Act Notice, see back of Copy D.
OMB No. 1545-0008
For Official Use Only
.25"
2
3
4
5
.3
.3
.3
.3
.3
.3
.25"
6
7
3.35"
2.0"
2.15"
.15"
8
9
1.6"
1.75"
10
11
12
13
14
16
17
18
19
20
21
22
15
Form W-2 Wage and Tax Statement 1982
Copy A For Social Security Administration
• See Instructions for Forms W-2 and W-2P
Department of the Treasury
Internal Revenue Service
7.5"
8.0"
11"

Notes:

1. Vertical measurements must be the same as the official 7" width form.
2. The form identification number must consist of 222 in an OCR A font and placed in print positions 19-21 measuring from the left page edge with 10 print positions per inch.
3. The Employer's Identification Number (EIN) may be preprinted anywhere in box 2.
4. The printer's EIN must be printed in the bottom margin of the face of each individual form of Copy A.
5. The titles for all numbered boxes for federally-required entries must correspond to the official form.
6. The ballot boxes must be 8-point boxes.
7. The ballot boxes contained in box 5 must be aligned exactly the same from the right rule of the form regardless of the width of the Form W-2 (i.e., 7", 7½", or 8").

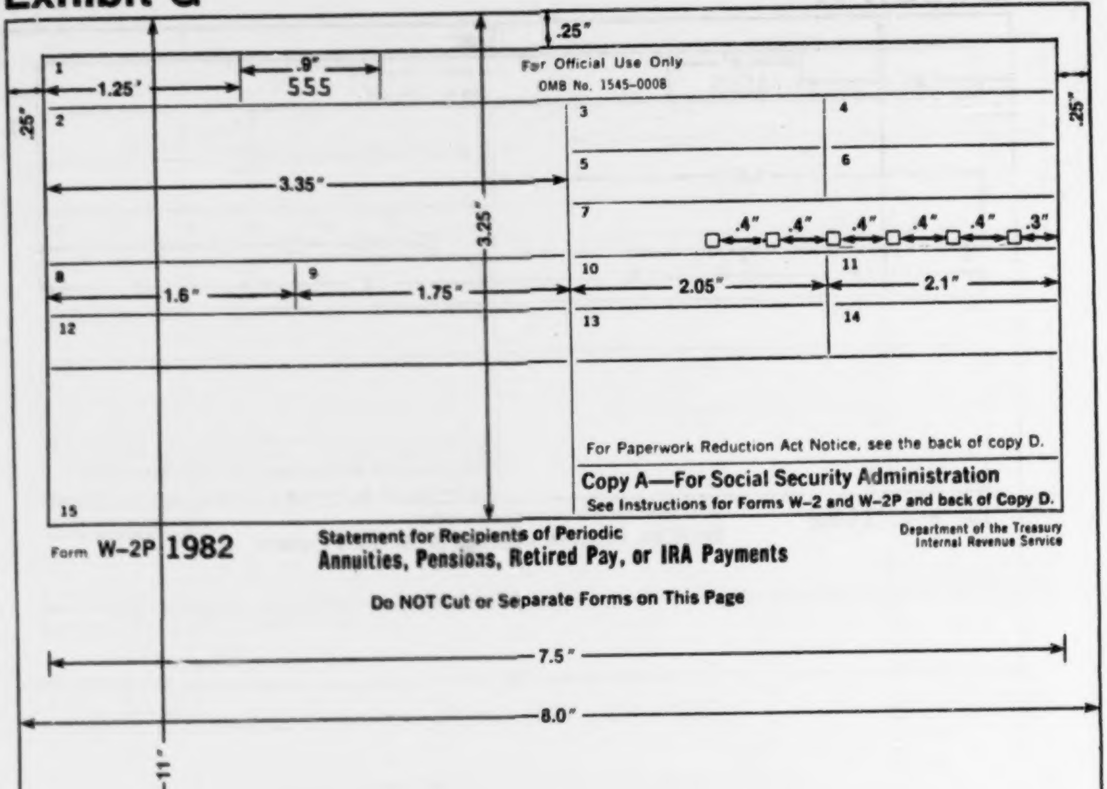
Exhibit F


.25"
1.3"
.9"
2222
For Paperwork Reduction Act Notice, see back of Copy D.
OMB No. 1545-0008
For Official Use Only
.25"
.25"
2
3
4
5
.3"
.3"
.3"
.3"
.3"
.3"
.15"
6
7
3.35"
1.80"
1.85"
8
9
1.6"
1.75"
10
11
12
13
14
16
17
18
19
20
21
22
15
Form W-2 Wage and Tax Statement 1982
Copy A For Social Security Administration
• See Instructions for Forms W-2 and W-2P
Department of the Treasury
Internal Revenue Service
7.0"
7.5"
11"

Notes:

1. Vertical measurements must be the same as the official 7" width form.
2. The form identification number must consist of 2222 in an OCR A font and placed in print positions 19-22 measuring from the left page edge with 10 print positions per inch.
3. The Employer's Identification Number (EIN) may be preprinted anywhere in box 2.
4. The printer's EIN must be printed in the bottom margin of the face of each individual form of Copy A.
5. The titles for all numbered boxes for federally-required entries must correspond to the official form.
6. The ballot boxes must be 8-point boxes.
7. The ballot boxes contained in box 5 must be aligned exactly the same from the right rule of the form regardless of the width of the Form W-2 (i.e., 7", 7½", or 8").

Exhibit G



For Official Use Only
OMB No. 1545-0008

For Paperwork Reduction Act Notice, see the back of copy D.

Copy A—For Social Security Administration
See Instructions for Forms W-2 and W-2P and back of Copy D.

Form **W-2P** **1982**

Statement for Recipients of Periodic
Annuities, Pensions, Retired Pay, or IRA Payments

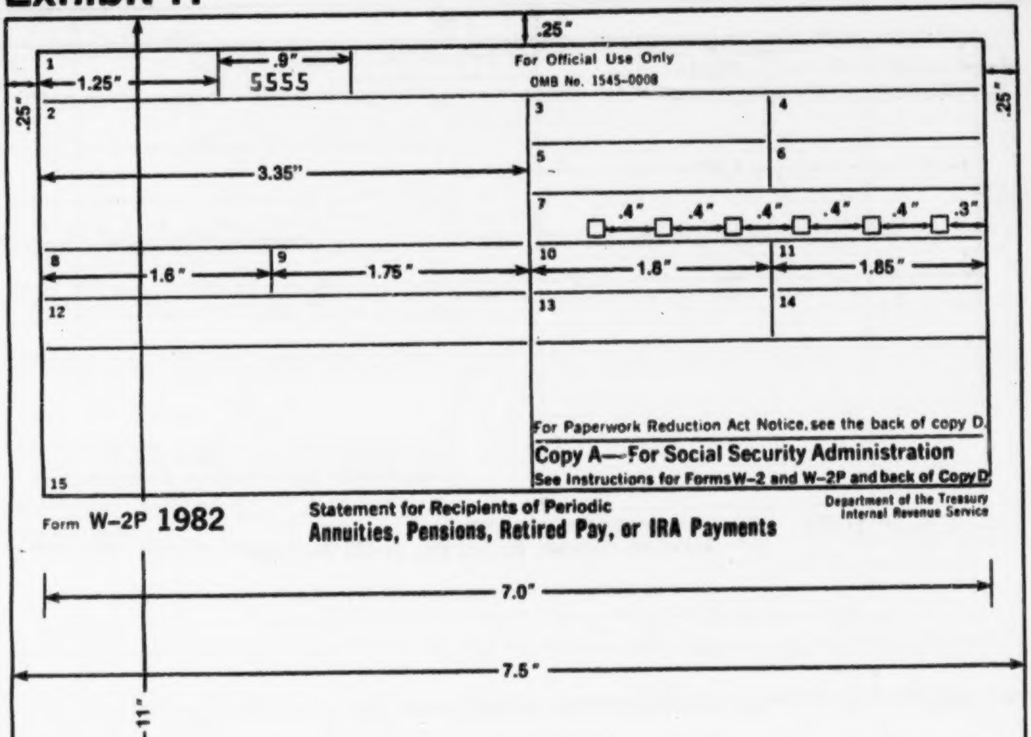
Department of the Treasury
Internal Revenue Service

Do NOT Cut or Separate Forms on This Page

Notes:

1. Vertical measurements must be the same as the official 7" width form.
2. The form identification number must consist of 555 in an OCR A font and placed in print positions 18-20 measuring from the left page edge with 10 print positions per inch.
3. The blank space to the right of box 15 and below boxes 13 and 14 may be used for any additional payee information.
4. The Employer's Identification Number (EIN) may be preprinted anywhere in box 2.
5. The printer's EIN must be printed in the bottom margin of the face of each individual form of Copy A.
6. The titles for all numbered boxes for federally-required entries must correspond to the official form.
7. The ballot boxes must be 8-point boxes.
8. The ballot boxes contained in box 7 must be aligned exactly the same from the right rule of the form regardless of the width of the Form W-2P (i.e., 7", 7½", or 8").

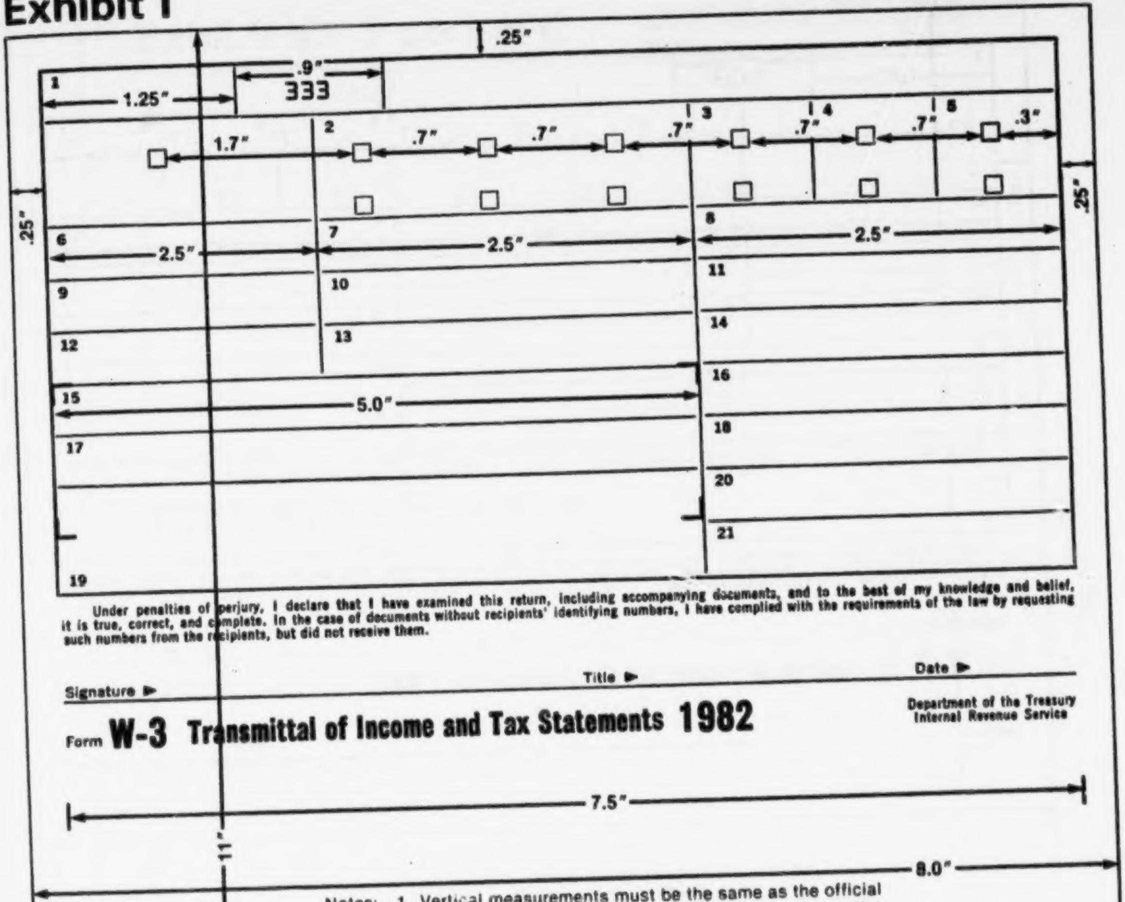
Exhibit H


.25"
1
1.25"
.9"
5555
For Official Use Only
OMB No. 1545-0008
.25"
.25"
2
3
4
5
6
3.35"
7
.4"
.4"
.4"
.4"
.4"
.3"
8
1.6"
9
1.75"
10
1.8"
11
1.85"
12
13
14
For Paperwork Reduction Act Notice, see the back of copy D.
Copy A—For Social Security Administration
See Instructions for Forms W-2 and W-2P and back of Copy D.
15
Form W-2P 1982
Statement for Recipients of Periodic
Annuities, Pensions, Retired Pay, or IRA Payments
Department of the Treasury
Internal Revenue Service
7.0"
7.5"
11"

Notes:

1. Vertical measurements must be the same as the official 7" width form.
2. The form identification number must consist of 5555 in an OCR A font and placed in print positions 18-21 measuring from the left page edge with 10 print positions per inch.
3. The blank space to the right of box 15 and below boxes 13 and 14 may be used for any additional payee information.
4. The Employer's Identification Number (EIN) may be preprinted anywhere in box 2.
5. The printer's EIN must be printed in the bottom margin of the face of each individual form of Copy A.
6. The titles for all numbered boxes for federally-required entries must correspond to the official form.
7. The ballot boxes must be 8-point boxes.
8. The ballot boxes contained in box 7 must be aligned exactly the same from the right rule of the form, regardless of the width of the Form W-2P (i.e., 7", 7½", or 8").

Exhibit I



Under penalties of perjury, I declare that I have examined this return, including accompanying documents, and to the best of my knowledge and belief, it is true, correct, and complete. In the case of documents without recipients' identifying numbers, I have complied with the requirements of the law by requesting such numbers from the recipients, but did not receive them.

Signature ▶ Title ▶ Date ▶

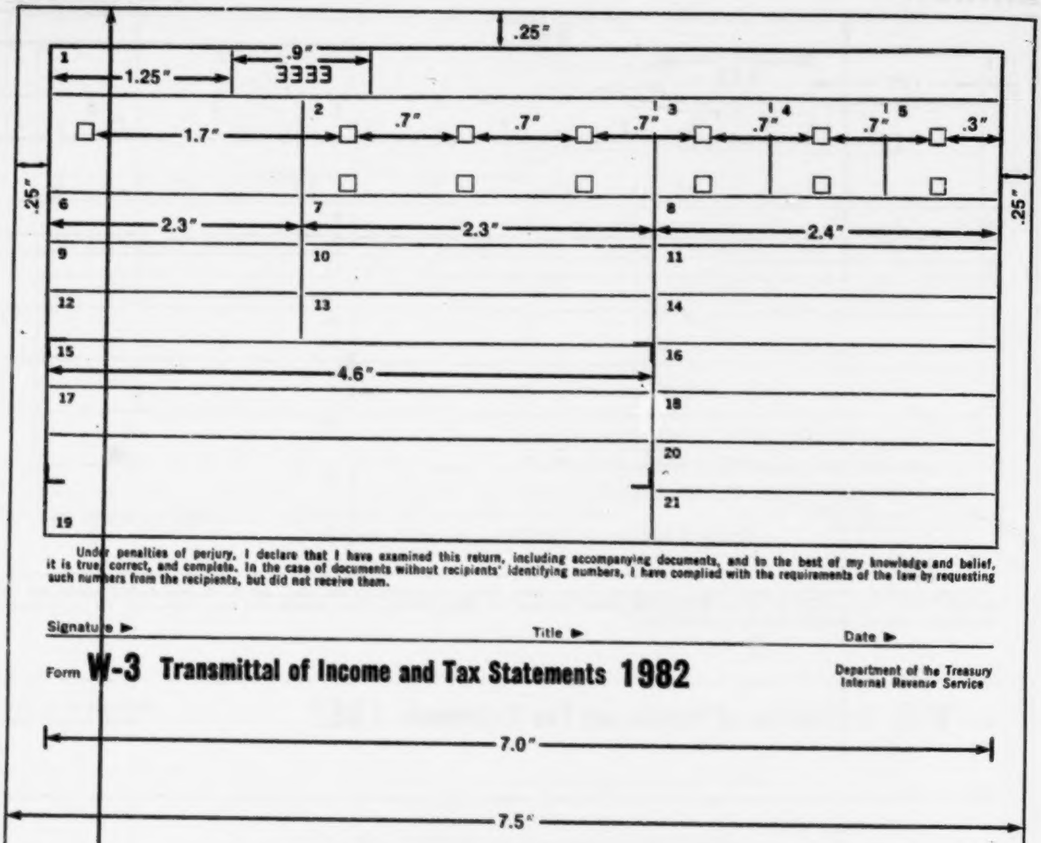
Form **W-3** **Transmittal of Income and Tax Statements 1982**

Department of the Treasury
Internal Revenue Service

Notes:

1. Vertical measurements must be the same as the official 7" width form except the mark sense squares (i.e., ballot boxes) in Boxes 2-5 may be moved down to conform to a six line per inch spacing.
2. The Form Identification Number must consist of 333 in an OCR A font and placed in print positions 18-20 measuring from the left page edge with 10 print positions per inch.
3. The Employer's Identification Number (EIN) may be preprinted in (OCR A font) anywhere in box 15.
4. The printer's EIN must be printed centered below the "signature" line.
5. The titles for all numbered boxes must correspond to the official form.
6. The ballot boxes must be 8-point boxes.
7. The ballot boxes contained in box 2, 3, 4, and 5 must be aligned exactly the same from the right rule of the form regardless of the width of the Form W-3 (i.e., 7", 7½", or 8").
8. The words "Please return this entire page to the Social Security Administration address for your State as listed below." and the appropriate SSA addresses must appear any substitute Form W-3 in the same position as on the official form.

Exhibit J



Under penalties of perjury, I declare that I have examined this return, including accompanying documents, and to the best of my knowledge and belief, it is true, correct, and complete. In the case of documents without recipients' identifying numbers, I have complied with the requirements of the law by requesting such numbers from the recipients, but did not receive them.

Signature ► Title ► Date ►

Form **W-3** **Transmittal of Income and Tax Statements** **1982**

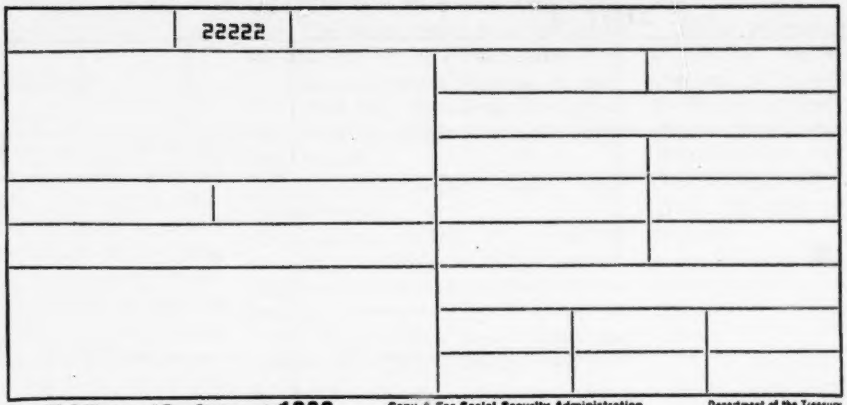
Department of the Treasury
Internal Revenue Service

Notes:

1. Vertical measurements must be the same as the official 7" width form except the mark sense squares (i.e., ballot boxes) in Boxes 2-5 may be moved down to conform to a six line per inch spacing.
2. The Form Identification number must consist of 3333 in an OCR A font and placed in print positions 18-21 measuring from the left page edge with 10 print positions per inch.
3. The Employer's Identification Number (EIN) may be preprinted anywhere in box 15.
4. The printer's EIN must be printed centered below the "signature" line.
5. The titles for all numbered boxes must correspond to the official form.
6. The ballot boxes must be 8-point boxes.
7. The ballot boxes contained in box 2, 3, 4 and 5 must be aligned exactly the same from the right rule of the form regardless of the width of the Form W-3 (i.e., 7", 7½", or 8").
8. The words "Please return this entire page to the Social Security Administration address for your State as listed below." and the appropriate SSA addresses must appear on any substitute Form W-3 in the same position as on the official form.

Note: Exhibits K, L, and M are shown with the descriptive information that must be printed in nonreflective black ink. All other printing will be in red OCR drop-out ink.

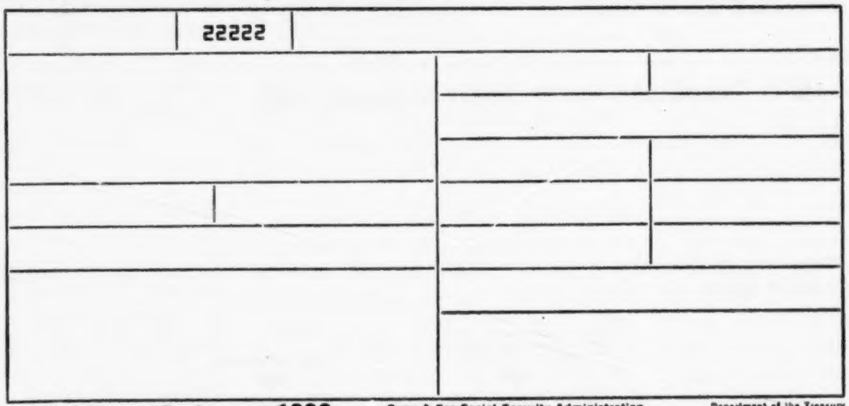
Exhibit K - 6 part W-2



22222

Form **W-2 Wage and Tax Statement 1982** Copy A For Social Security Administration
* See Instructions for Forms W-2 and W-2P
Department of the Treasury
Internal Revenue Service

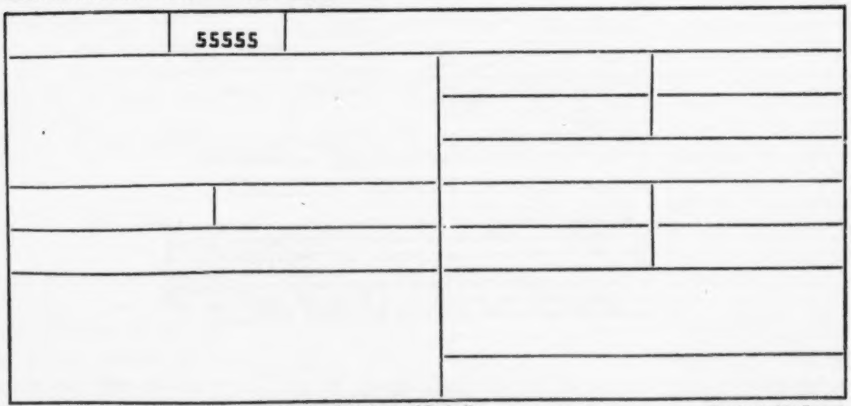
Exhibit L - 4 part W-2



22222

Form **W-2 Wage and Tax Statement 1982** Copy A For Social Security Administration
* See Instructions for Forms W-2 and W-2P
Department of the Treasury
Internal Revenue Service

Exhibit M - W-2P



55555

Form **W-2P 1982** **Statement for Recipients of Periodic Annuities, Pensions, Retired Pay, or IRA Payments**
Department of the Treasury
Internal Revenue Service

Exhibit N - W-3

Note: Exhibit N is shown with the descriptive information that must be printed in nonreflective black ink. All other printing will be in red OCR red dropout ink.

33333

Under penalties of perjury, I declare that I have examined this return, including accompanying documents, and to the best of my knowledge and belief, it is true, correct, and complete. In the case of documents without recipients' identifying numbers, I have complied with the requirements of the law by requesting such numbers from the recipients, but did not receive them.

Signature ► Title ► Date ►

Form **W-3** **Transmittal of Income and Tax Statements 1982**

Department of the Treasury
Internal Revenue Service

Please return this entire page to the Social Security Administration address for your State as listed below.

If your legal residence, principal place of business, office or agency is located in ▼	Use this address ▼
Alaska, Arizona, California, Colorado, Hawaii, Idaho, Iowa, Minnesota, Missouri, Montana, Nebraska, Nevada, North Dakota, Oregon, South Dakota, Utah, Washington, Wisconsin, Wyoming	Social Security Administration Salinas Data Operations Center Salinas, CA 93911
Alabama, Arkansas, Florida, Georgia, Illinois, Kansas, Louisiana, Mississippi, New Mexico, Oklahoma, South Carolina, Tennessee, Texas	Social Security Administration Albuquerque Data Operations Center Albuquerque, NM 87180
Connecticut, Delaware, District of Columbia, Indiana, Kentucky, Maine, Maryland, Massachusetts, Michigan, New Hampshire, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Rhode Island, Vermont, Virginia, West Virginia	Social Security Administration Wilkes-Barre Data Operations Center Wilkes-Barre, PA 18769
If you have no legal residence or principal place of business in any State	Social Security Administration Wilkes-Barre Data Operations Center Wilkes-Barre, PA 18769

Paperwork Reduction Act Notice.—The Paperwork Reduction Act of 1980 says we must tell you why we are collecting this information, how we will use it, and whether you have to give it to us. We ask for the information to carry out the Internal Revenue laws of the United States. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax. You are required to give us this information.

26 CFR 601.602: Forms and instructions.
(Also Part I, Sections 1441, 1442, 1443, 1461, 1462, 1463, 1464, 6011; 1.1441-1, 1.1442-1, 1.1443-1, 1.1461-2, 1.1462-1, 1.1463-1, 1.1464-1, 1.6011-1.)

Rev. Proc. 82-13

PART "A"—GENERAL

SECTION 1. PURPOSE.

.01 The purpose of this Revenue Procedure is to update and supersede Rev. Proc. 79-20, 1979-1 C.B. 527, which sets forth the requirements and conditions under which withholding agents, as defined in Section 1.02 below, may file Form 1042S information returns on magnetic tape beginning with TAX YEAR 1981 RETURNS.

.02 A withholding agent is defined as any person or entity required to withhold U.S. tax on payments of income subject to withholding from sources within the United States as provided for in Chapter 3 of the Internal Revenue Code. A withholding agent may be an individual, partnership, corporation, trust, estate, government agency (Federal, State or local), association, or a tax-exempt foundation or organization.

.03 The Internal Revenue Service encourages all entities who must file information returns and who have facilities for submitting this information on magnetic tape to use this method of filing. Withholding agents filing Form 1042S information returns in the form of magnetic tape should also be aware of the current Revenue Procedures, relating to magnetic tape reporting for wage and information documents, disk-pack reporting for wage and information documents, and diskette reporting for wage and information documents. Copies of the above mentioned Revenue Procedures are available from any Internal Revenue Service Center.

SEC. 2. APPLICATION FOR TAPE REPORTING.

.01 Form 1042S statements may be filed on magnetic tape by withholding agents or by their designated agents. Tape reporting is not restricted to withholding agents with the ability to submit all their information on magnetic tape; a combination of tape records and paper documents is acceptable so long as there is no duplication or omission of documents.

.02 Withholding agents or their designated agents who desire to file statements in the form of magnetic tape must first file a letter of application. This letter should be addressed to the Director of the Philadelphia Service Center, Internal Revenue Service, P.O. Box 245, Bensalem, Pennsylvania 19020, Attention: Magnetic Media Coordinator.

The letter of request must contain the following:

(a) Name, address, and Employer Identification Number (EI) of person, organization or entity making the request.

(b) Name, title, and telephone number of person to contact regarding the request.

(c) An estimate of the number of 1042S statements to be reported in tape format, and the number, if any, to be reported on paper forms.

(d) Type and nature of equipment to be used to prepare tape; i.e. manufacturer and model of main frame and tape drives, tape width (½", ¾", etc.), density (character per inch), and recording code (BCD, Excess 3, Octal, etc.).

(e) List of withholding agents to be included in the file(s) if the requester is an agent designated to file for a group of withholding agents. This list must include each withholding agent's name, complete address (including Zip Code), and EI number. The list should be in EI number sequence.

(f) Signature of official responsible for the preparation of tax reports or his authorized agent.

.03 The Service will act on applications and notify applicants of authorization or disapproval within 30 days of receipt of applications.

.04 Generally, withholding agents using equipment compatible with the Service's can presume that their application will be approved. Compatible tape characteristics are shown in PART "B", Section 1.01.

Where the capability to prepare several types of tapes exists, the Service prefers that compatible tapes be prepared.

.05 If withholding agents propose to submit convertible tapes, the Service will attempt to find conversion facilities. Generally, an application to file on magnetic tape will be disapproved only when the Service is unable to obtain facilities to convert a withholding agent's file to a compatible form.

.06 In general, once authorization to file on magnetic tape has been granted, such approval will continue in effect in succeeding years, providing that the requirements of this Revenue Procedure are met and there are no equipment changes by the withholding agent. However, new applications are required:

(a) If the users change from equipment producing compatible tapes to equipment producing convertible tapes.

(b) If the users submit tapes that are not listed as either compatible or convertible.

(c) If the users discontinue tape reporting for one or more years, then decide to resume this method of reporting.

SEC. 3. FILING OF TAPE REPORTS.

.01 Packaging, shipping, and mailing instructions will be provided in the authorizing letter issued by the Service in response to an application for tape reporting.

.02 Withholding agents submitting a portion of their statements on magnetic tape and the remainder on paper forms, should file both magnetic tape records and paper documents at the Philadelphia Service Center, but in separate shipments.

.03 The withholding agent's Form 1042 tax return serves as the transmittal document for Form 1042S statements, including those on paper and on magnetic tape. For designated agents filing statements on tape for several withholding agents, separate Forms 1042 must be filed for each withholding agent included in the transmittal. Since the required Form 1042 is a tax return (with or without a remittance attached), it must be filed separately from the shipment of magnetic tape. Attach a statement to Form 1042 giving the number of Forms 1042S on magnetic tape and the number (if any) filed on paper. The total of Forms 1042S must be inserted on line 16a, Form 1042. Any additional documents required to be submitted should accompany Form 1042. (See instructions for Form 1042, U.S. Annual Return of Income Tax To Be Paid At Source under Chapter 3, Internal Revenue Code.)

.04 The dates prescribed for filing paper documents with the Service will also apply to magnetic tape filing. Requests for extensions of time for filing and related matters should be made to the Director, Philadelphia Service Center. If an extension has been granted by the Service a copy of the letter granting the extension should be attached to the Form 1042.

.05 Enclose a transmittal in triplicate, in the first box of the tape shipment, with the following information:

(a) The complete name, address, and EI number of the transmitter of the tape file.

(b) Name, address, title, and telephone number of the person to contact regarding any tape file problem.

(c) The complete name and address to be used in returning the tape file.

(d) The manufacturer and model of the main frame and tape drives, the tape width, the density in characters per inch, and the recording code (BCD, Excess 3, Octal, etc.).

(e) The type of document being reported—i.e. Form 1042S.

(f) Total number of tape reels in the file.

.06 Ship to Internal Revenue Service Center, Bensalem, PA 19020. Note on the address side of the shipment: "EXPEDITE FORM 1042S STATEMENTS ON MAGNETIC TAPE. DELIVER UNOPENED TO TAPE LIBRARY."

.07 The magnetic tape specifications contained in PART "B" of this Revenue Procedure must be strictly adhered to. Deviations will not be permitted under any circumstances. All magnetic tape filings will be scanned for completeness of required fields, mathematical verification, and proper format. Tapes failing to meet specifications will not be processed, but will be returned to the transmitter for correction at the discretion of the Director, Philadelphia Service Center.

SEC. 4. PROCESSING OF TAPE STATEMENTS.

.01 The Service will copy the information from the original tapes and will return the original tapes to the withholding agent. Normally, tapes will be returned by September 15 of the year in which submitted. However, if the tapes submitted are unprocessable, and must be returned for correction prior to processing, they will be returned within six months of the receipt of acceptable tapes.

.02 The Service will prepare the appropriate statements for transmittal to Treaty countries.

SEC. 5. CORRECTED STATEMENTS.

.01 The appropriate paper forms will normally be used if it is necessary to correct Recipient "Q" records in the magnetic tape files. Since corrected statements supersede information previously supplied, all required data fields must be completed. Annotate each form "Corrected" at the top. Corrected documents should be bundled separately from other paper documents. When correcting documents are shipped separately, an amended Form 1042 must also be filed, also suitably annotated.

.02 If it becomes necessary for the withholding agent to submit a large volume of corrected statements, the Service would prefer that corrected statements be provided on tape. If the withholding agent possesses the capability to provide such corrections on tape, he should contact the Philadelphia Service Center, Magnetic Media Coordinator, for instructions.

SEC. 6. EFFECT ON PAPER DOCUMENTS.

.01 Magnetic tape reporting to Internal Revenue Service eliminates the need for submission of paper Forms 1042S. However, withholding agents must continue to provide recipients with requisite information, although this need not be on a copy of Form 1042S.

.02 If only a portion of the statements is reported on magnetic tape and the remainder is reported on paper forms, those paper statements must be filed on the prescribed forms.

SEC. 7. DATA ENTRIES.

.01 Since taxpayer identifying numbers are not required on all Forms 1042S (see specific Instructions for Withholding Agents, Copy D of the official Form 1042S), the specifications in PART "B" of this Revenue Procedure permit omission of such iden ing numbers. Although identify numbers are not always required nonresident alien income recipie the Service appreciates their being nished when available, because identifying numbers are helpful in dit and return-matching programs.

.02 Recipient surnames are usec computer-generate Sort Names. an asterisk to indicate the beginning the surname for this purpose. If surname is the first name on the li as may be the case for nationals Asian countries, the asterisk is to omitted. In the case of a partnersl or joint ownership, or some other c where more than one individual is l ed, asterisk only the first surname. blank will always precede the aster when it is used, but no asterisk may followed by a blank. Do not use an terisk with corporate names or a other business entity or governmen organization name, except partn ships or sole proprietorships.

.03 In case of multiple recipien the name of the person whose identi ing number has been provided shou be placed before all other names.

.04 Sometimes the recipient ide tification recorded on the withholdi agent's records is lengthy, and excee the 105 characters alloted in the R cipient Name Line and the Suppl mental Name Lines on the magnet tape records. This is most common the case of trusts or other types of fid ciary accounts. The first 105 chara ters of the recipient identification no mally provide sufficient descripti data for the Service's purposes. Th Service encourages all agents to mak every possible attempt to truncate abbreviate lengthy recipient descri tions.

.05 All monetary amount field must show dollars and cents (omit th decimal point). For example, $135.7 must be shown as 13572, and $10 must be shown as 10000. All mone amount fields are positive and mus not be signed in any fashion. Al money amounts must be right-justifie and zero filled. Do not truncate an money amount fields. If the amount i more than the allowed space, prepar a second "Q" record to show the difference.

SEC. 8. ADDITIONAL INFORMATION.

Requests for additional copies of this Revenue Procedure, or request for additional information on tape reporting, should be addressed to the Internal Revenue Service, Philadelphia Service Center, Post Office Box 245, Bensalem, Pennsylvania 19020.

PART "B"—MAGNETIC TAPE SPECIFICATIONS

SECTION 1. GENERAL.

.01 These specifications prescribe the required format and content of the records to be included in the file, but not the methods or equipment to be used in their preparation. Usually, the Service will be able to process, without translation, any compatible tape file. To be compatible, a tape file must meet all of the following:

Type of Tape – ½ inch Mylar base, oxide coated
Recording Density – 556 or 800 BPI
Parity – Even or Odd
Interrecord gap – ¾ inch
Reading Code – 7 channel binary coded decimal (BCD)

.02 Convertible tapes for which conversion facilities are currently available are:

(a) 9 Channel EBCDIC (Extended Binary Coded Decimal Interchange Code);

(1) Odd Parity

(2) 800, 1600 and 6250 Densities

(b) 9 Channel ASC II (American Standard Coded Information Interchange);

(1) Odd Parity

(2) 800, 1600 Densities

(c) 200 Density

.03 An acceptable tape file for each withholding agent will contain data records as follows:

(a) Single Reel

(1) a Transmitter "T" Record; then

(2) one or more Recipient "Q" Records followed by a specific Withhold Agent "W" Record; then

(3) additional "Q" and "W" Record sequences for other withholding agents as needed; then

(4) an End of Transmission "Y" Record.

(b) Multiple Reels

(1) a Transmitter "T" Record at the beginning of each reel; then

(2) sequences of Recipient "Q" Records followed with corresponding Withholding Agent "W" Records; then

(3) and End of Reel "Z" Record on every reel except the last; and

(4) and End of Transmission "Y" Record ending the last reel.

(c) Notes

(1) a sequence of Recipient "Q" Records may be continued from one reel to the next if they apply to the same withholding agent, without the necessity of repeating the "W" Record. The sequence might be, for example,. . .QQQQZ (end of one reel); TQQQQW. . .(beginning of next reel).

(2) the End of Reel "Z" Record is identical to the Withholding Agent "W" Record, except that it also indicates the end of the reel. For example, when records for a specific withholding agent conclude at the end of a reel, the "Z" Record will be used in lieu of a "W" Record; the next tape reel will begin with a "T" Record, followed by "Q" records for an entirely new withholding agent.

.04 Affix an external label to each tape with the following information:

(1) Name of Transmitter.

(2) Number of "Q" records on that reel.

(3) Density (200, 556, 800, 1600 CPI, etc.).

(4) Channel (7 or 9).

(5) Parity (odd or even).

(6) Manufacturer and model of main frame and tape drives.

(7) Sequence number of reel, and total reels in the file (i.e. 1 of 3, 2 of 4, etc.).

.05 All records, including Header and Trailer Labels (if used) must be transmitted at the same density.

SEC. 2. CONVENTIONS AND DEFINITIONS.

.01 Header Labels, Trailer Labels, Record Marks and Tape Marks are all optional. They may be used as required by the transmitter's equipment or programming. If used they must conform to the following standards:

(a) Header Labels must begin HDR1 or 1HDR. If used, they must be the first record on the reel immediately before the Transmitter "T" Record. Header labels may not exceed 80 characters in length. Headers are not read onto IRS magnetic media, but are automatically omitted. Thus, no Header may contain E, T, Q, W, Y, or Z in position 9, since this causes Service equipment to read data immediately following as if it were part of a record.

(b) Trailer Labels must begin 1EOR, 1EOF, EOF1, or EOR1. If used, they must be the last record on the reel, after the "Z" or "Y" Record and Tape Mark (if a Tape Mark is used). Trailer Labels may not exceed 80 characters in length.

(c) Record Marks, if used, may only appear at the end of a record or block. Use IBM Record Mark 111010 (Octal 72) in even parity, 011010 in odd. All Records are of uniform length, and marks are not needed.

(d) Tape Marks, if used, must be IBM 001111 (Octal 17) in even parity. They always appear immediately after the "Z" or "Y" Record. If Header and Trailer Labels are also used, the tape mark must precede the Header Label and must follow the Trailer Label.

.02 Definitions:

Element	*Description*
b	Denotes a blank position. For compatibility with Service equipment, use BDC bit configuration 010000 ("A" bit only) in even parity, 001101 ("841" bits) in odd parity.
Special Character	Any character that is not a numeral, a letter, or a blank.
Withholding Agent	Person or organization, including withholding agent, making payments. The withholding agent is responsible for the completeness, accuracy, and timely submission of magnetic tape files.

Element	*Description*
Transmitter	Person or organization preparing and filing tape files. May be withholding agent or his designated agent.
Recipient	Person(s) or organization(s) receiving payments from withholding agent.
Record	A group of related fields of information treated as a unit.
Blocked Records	Two or more records grouped together between inter-record gaps.
Unblocked Records	A single record which is written between interrecord gaps.
File	For the purpose of this Procedure, a file consists of all tape records submitted by a transmitter.
Reel	A spool of magnetic tape.
EIN	Employer Identification Number which has been assigned by the Service to the withholding entity.
SSN	Social Security Number.

SEC. 3. RECORD LENGTH AND BLOCKING.

.01 Tape records prescribed in the specifications may be blocked or unblocked, subject to the following:

(a) All data records are of a fixed length.

(b) All records may be blocked, except Header and Trailer Labels.

(c) A block may not exceed 4,000 tape positions, although shorter blocks may be written as desired. If full-length blocks are being used, but sufficient records are not available to fill them, the block should be "padded" with 9's to fill all unused positions. Do not pad the block with blanks, or create blank records (for example, Q followed by 391 blanks, etc.).

(d) Two forms of blocking are acceptable:

(1) Only "Q" Records are blocked; all other records are unblocked.

(2) All records, except Header and Trailer Labels, if used, are blocked. In this case, a "I" Record may only be the first record in the first block on the reel; a "W" Record may only be the last record in a block and must follow all associated "Q" Records; and, "Y" or "Z" Records may only be the last record in the last block on the reel.

.02 The first position of each record indicates the record type:

Transmitter	T
Recipient	Q
Withholding Agent	W
End of Reel	Z
End of Transmission	Y

.03 The minimum file transmitted must consist of a Transmitter "T" Record, a Recipient "Q" Record, a Withholding Agent "W" Record, and an End of Transmission "Y" Record.

SEC. 4. THE TRANSMITTER "T" RECORD.

This record identifies the entity who prepares and transmits the magnetic tape file. The Transmitter and one of the withholding agents may be the same, but they need not be. The Transmitter "T" Record must be the first record on a reel (second record, if header labels are used), and must appear on each reel in the file sent by the Transmitter. On multiple reel files, the reel number must be incremented by 1 (one) for each tape reel after the first reel. Each "T" Record has a fixed length of 388 positions. The elements of data prescribed for each "T" Record are as follows:

Element	*Positions*	*Title*	*Description*
1	1	Record Type	Enter letter "T".
2	2 & 3	Tax Year	Enter the last two digits of the year for which income & withholding is being reported. All recipient "Q" and transmittal "T" Records on the file for every withholding agent *must* report payments for this year, and this year *only*. Transmit separate Forms 1042 and tape files for different Tax Years.
3	4 & 5	Reel Number	The two-digit serial number assigned by the Transmitter to this reel, starting with 01. If Header Labels are used, this should be the same as the Reel Sequence Number.
4	6 to 14	EIN	Enter the Employer Identification Number of the *Transmitter*. Omit hyphen.
5	15 to 54	Transmitter Name	Enter name of submitter of file; left justify and blank fill. Abbreviate if necessary to fit 40-character limit. Omit punctuation marks except hyphens and ampersands.
6	55 to 94	Street Address	Enter Street Address, PO Box, or other location of Transmitter. Left justify and blank fill. Abbreviate as needed to fit 40-character limit.

Element	*Positions*	*Title*	*Description*
7	95 to 114	City	Enter City, Town, APO/FPO, etc. of Transmitter. Left justify and blank fill. Abbreviate to fit 20-character limit.
8	115 & 116	State Code	Enter two-letter PO Code as shown in the list below *only*. Do not spell out any state name.

State Codes

State	*Code*
Alabama	AL
Alaska	AK
Arizona	AZ
Arkansas	AR
California	CA
Colorado	CO
Connecticut	CT
Delaware	DE
District of Columbia	DC
Florida	FL
Georgia	GA
Hawaii	HI
Idaho	ID
Illinois	IL
Indiana	IN
Iowa	IA
Kansas	KS
Kentucky	KY
Louisiana	LA
Maine	ME
Maryland	MD
Massachusetts	MA
Michigan	MI
Minnesota	MN
Mississippi	MS
Missouri	MO
Montana	MT
Nebraska	NE
Nevada	NV
New Hampshire	NH
New Jersey	NJ
New Mexico	NM
New York	NY
North Carolina	NC
North Dakota	ND
Ohio	OH
Oklahoma	OK
Oregon	OR
Pennsylvania	PA
Rhode Island	RI
South Carolina	SC
South Dakota	SD
Tennessee	TN
Texas	TX
Utah	UT
Vermont	VT
Virginia	VA
Washington	WA
West Virginia	WV
Wisconsin	WI
Wyoming	WY
American Samoa	AS
Canada	CD
Guam	GU
Mexico	MX
Puerto Rico	PR
Virginia Islands	VI

Notes:

(1) For other Foreign countries use XX.

(2) APO & FPO addresses *must* show a city, state, and Zip. Do *not* use "XX" for APO & FPO; the four permissible State codes are "NY", "CA", "WA", and "FL".

Element	*Positions*	*Title*	*Description*
9	117 to 121	ZIP Code	Enter the Zip Code of the Transmitter for all U.S., U.S. Territory or Possession, APO/FPO addresses. For Transmitters outside the U.S., enter five zeros only. DO NOT blank fill.
10	122 to 388	Blanks	Blank fill the rest of the "T" Record.

SEC. 5. RECIPIENT "Q" RECORD.

This Record contains complete name and address data for both Withholding Agent and Recipient of Income, together with all the particulars of the income paid and tax withheld. Complete Withholding Agent data is required because each Recipient "Q" Record is treated as if it were a separate Form 1042S, and is processed independently of other records. Since the "Q" Record is restricted to one type of income only, it may be necessary to write more than one "Q" Record (up to 20) for any given individual income recipient, who may have received income of more than one type. All Recipient "Q" Records for a particular Withholding Agent must be written before the corresponding Withholding Agent "W" Record, and before "Q" Records for another Withholding Agent may begin. Any order of "Q" Records within those belonging to a given Withholding Agent may be used (for example, they may be sorted alphabetically by surname, or by country code, or by country of the mailing address, etc.) at the convenience of the Transmitter or Withholding Agent, since the "Q" Records are fully independent. All "Q" Records have a fixed length of 392 positions. All Elements are required unless otherwise stated.

Element	*Positions*	*Title*	*Description*
1	1	Record Type	Enter Q only.
2	2 to 10	Agent EIN	Enter the 9-digit Employer Identification Number of the Withholding Agent. Omit the hyphen.
3	11 to 45	Agent Name	Enter the name of the Withholding Agent up to the limit of 35 characters. Abbreviate as needed, omitting punctuation. Left justify and blank fill.

Element	*Positions*	*Title*	*Description*
4	46 to 80	Agent Address	Enter the Street address, PO Box, other location of the Agent to a limit of 35 characters. Abbreviate as needed, omitting punctuation. Left justify and blank fill.
5	81 to 100	City	Enter the city or town (or other locality name) up to the limit of 20 characters. Left justify and blank fill.
6	101 & 102	State Code	Enter the two-character alphabetic code in the list in Sec. 4., above. Do not spell out any state name.
7	103 to 107	Zip Code	Enter 5 numeric characters for all U.S. addresses (including territories, possessions, and APO/FPO). Zero fill for addresses outside the U.S.
8	108	Account Type Code	Enter "1" for U.S. business or organization; Element 9 *must* have an EIN. Enter "2" for U.S. citizen or resident alien; Element 9 *must* have SSN. Enter "3" for nonresident alien persons, businesses, or organizations. Element 9 *should* contain an EIN or SSN if one is available. Enter "4" if "1" or "2" applies, but an SSN or EIN is not available for a legitimate reason; for example, a number has been applied for but not received.
9	109 to 117	TIN	Enter recipient's U.S. identification number; if Element 8 has a "1", you must enter an EIN; if Element 8 has a "2", you must enter an SSN; if Element 8 has a "3", enter an EIN or SSN if available—otherwise enter blanks; if Element 8 has a "4" you must enter blanks.
10	118 to 127	Agent's ID Number	Enter the account number assigned by the Withholding Agent for this recipient. This number is used to facilitate identification of the specific record if there is any correspondence. Left justify and blank fill. This Element will be all blank if account numbers are not assigned. This field may contain numeric or alphabetic characters, blanks, or hyphens.
11	128 & 129	Country Code	Enter two alphabetic characters from the list below which represents the official country of legal residence for the recipient. This may or may not be the same as the country given in Element 20, below. Entry of a true country code is mandatory. "OC" (country unknown or not identified) is to be used with great reluctance; THE TAPE FILE WILL BE RETURNED FOR CORRECTION AT THE DISCRETION OF THE SERVICE CENTER DIRECTOR IF A SUBSTANTIAL NUMBER OF "Q" RECORDS SHOW COUNTRY CODE "OC". WHENEVER COUNTRY CODE "OC" IS USED, THE RATE OF TAX WITHHELD MUST EQUAL 30%.

Country Codes

Country	*Code*
Afghanistan	AF
Albania	AL
Algeria	AG
American Samoa	AQ
Andorra	AN
Angola	AO
Antarctica	AY
Antigua	AC
Argentina	AR
Australia	AS
Austria	AU
Azores	PO
Bahamas, The	BF
Bahrain	BA
Bangladesh	BG
Barbados	BB
Belgium	BE
Belize	BH (Formerly British Honduras)
Benin	DM (Formerly Dahomey)
Bermuda	BD
Bhutan	BT
Bolivia	BL
Botswana	BC
Brazil	BR
British Indian Ocean Territory	IO
British Virgin Islands	VI
Brunei	BX
Bulgaria	BU
Burma	BM
Burundi	BY
Cambodia	CB
Cameroon	CM

Country	*Code*
Canada	CA
Canton & Enderbury Islands	EQ
Canary Islands	SP
Cape Verde, Republic of	CV
Cayman Islands	CJ
Central African Republic	CT
Chad	CD
Channel Islands	OC
Chile	CI
China (Peking)	CH
China (Taiwan)	TW
Christmas Island	KT
Cocos (Kneeling) Islands	CK
Colombia	CO
Comoros	CN
Congo	CF
Cook Islands	CW
Costa Rica	CS
Cuba	CU
Cyprus	CY
Czechoslovakia	CZ
Denmark	DA
Djibouti	DJ (Formerly Afars & Issas)
Dominica	DO
Dominican Republic	DR
Ecuador	EC
Egypt	EG
El Salvador	ES
England	UK
Equatorial Guinea	EK
Ethiopia	ET
Falkland Islands	FA (also known as Islas Malvinas)
Faroe Islands	FO
Fiji	FJ
Finland	FI
France	FR
French Guiana	FG
French Polynesia	FP
French Southern & Antarctic Lands	FS
Gabon	GB
Gambia, The	GA
German Democratic Republic	GC (East Germany)
Germany, Federal Republic of	GE (West Germany)
Ghana	GH
Gibraltar	GI
Gilbert Islands	GS
Greece	GR
Greenland	GL
Grenada	GJ
Guadeloupe	GP
Guam	GQ
Guatemala	GT
Guinea	GV
Guinea-Bissau	PU
Guyana	GY
Haiti	HA
Heard Island & McDonald Island	HM
Honduras	HO
Hong Kong	HK
Hungary	HU
Iceland	IC
India	IN
Indonesia	ID
Iran	IR (also known as Persia)
Iraq	IZ
Ireland	EI
Isle of Man	OC
Israel	IS
Italy	IT
Ivory Coast	IV
Jamaica	JM
Japan	JA
Johnston Atoll	JQ
Jordan	JO
Kenya	KE
Korea, Democratic Peoples Republic of	KN (North Korea
Korea, Republic of	KS (South Korea)
Kuwait	KU
Laos	LA
Lebanon	LE
Lesotho	LT
Liberia	LI
Libya	LY
Liechtenstein	LS
Luxemburg	LU
Macao	MC
Madagascar	MA
Malawi	MI
Malaysia	MY
Maldives	MV
Mali	ML
Malta	MT
Martinique	MB
Mauritania	MR
Mauritius	MP
Mexico	MX
Midway Islands	MQ
Monaco	MN
Mongolia	MG
Montserrat	MH
Morocco	MO
Mozambique	MZ
Nauru	NR
Navassa Island	BQ
Nepal	NP
Netherlands	NL (also called Holland)
Netherlands Antilles	NA
New Caledonia	NC
New Hebrides	NH
New Zealand	NZ
Nicaragua	NU
Niger	NG
Nigeria	NI
Niue	NE
Norfolk Island	NF
Northern Ireland	UK
Norway	NO
Oman	MU
Pakistan	PK
Panama	PN
Papua-New Guinea	PP
Paracel Islands	PF
Paraguay	PA
Peru	PE
Philippines	RP
Pitcairn	PC
Poland	PL
Portugal	PO
Portuguese Timor	PT
Puerto Rico	RQ
Qatar	QA
Reunion	RE
Romania	RO
Rwanda	RW
St Christopher-Nevis-Anguilla	SC (also called (St. Kitts)
St Helena	SH
St Lucia	ST
St Pierre & Miquelon	SB
St Vincent	VC
San Marino	SM
Sao Tome and Principe	TP
Saudi Arabia	SA
Scotland	UK
Senegal	SG
Seychelles	SE
Sierra Leone	SL
Singapore	SN
Solomon Islands	BP
Somalia	SO
South Africa	SF
Southern Rhodesia	RH

Country	*Code*
South-West Africa	WA (also called Namibia)
Spain	SP
Spratly Islands	PG
Sri Lanka	CE (also called Ceylon)
Sudan	SU
Surinam	NS
Svalbard & Jan Mayen	JS
Swaziland	WZ
Sweden	SW
Switzerland	SZ
Syria	SY
Tanzania	TZ
Thailand	TH
Togo	TO
Tokelau Islands	TL
Tonga	TN
Trinidad & Tobago	TD
Trust Territory of the Pacific Islands	TQ
Tunisia	TS
Turkey	TU
Turks & Caicos Islands	TK
Tuvalu	TV (also called Ellice Islands)
Uganda	UG
Union of Soviet Socialist Republic	UR
United Arab Emirates	TC
United Kingdom	UK
United States	US
Upper Volta	UV
Uruguay	UY
Vatican City	VT
Venezuela	VE
Vietnam	VM
Virgin Islands of the U.S.	VQ
Wake Island	WQ
Wales	UK
Wallis & Futuna	WF
Western Sahara	WI
Western Samoa	WS
Yemen (South)	YS
Yemen (North)	YE
Yugoslavia	YO
Zaire	CG
Zambia	ZA
Zimbabwe	RH

Element	*Positions*	*Title*	*Description*
12	130 to 164	1st Name Line	Enter full name of recipient, or if there are more than one, the name of the first recipient only. Use an asterisk to indicate the surname as shown in Section 7.02, above. Valid characters are alphabetic, numeric, ampersand (&), hyphen (-), slash (/), asterisk (*), and blank. A name MUST be entered here; if the recipient is a numbered bank account, and the true recipient is not known, the account number must be supplied here. THE TAPE FILE WILL BE RETURNED FOR CORRECTION AT THE DISCRETION OF THE SERVICE CENTER DIRECTOR IF A SUBSTANTIAL NUMBER OF "Q" RECORDS SHOW A BLANK 1st NAME LINE OR AN INVALID 1st NAME LINE. Left justify and blank fill.
13	165 to 199	2nd Name Line	Enter supplement name information of the recipient on this line. Use this line for additional names (e.g. of partners or joint owners), for trade names, stage names, aliases. Use this line also for *care-of, via,* or *through* information. Valid characters are the same as in the 1st name line, except for the asterisk (*) which is invalid here, and the percent (%) which is valid in the first position only (as shorthand for "care of"). If no additional name data is to be provided, blanks are to be inserted. Left justify and blank fill.
14	200 to 234	3rd Name Line	Enter further name data if applicable; otherwise blank fill. Specifications are precisely as for the 2nd Name Line. See Street Address, below.

NOTE: 105 total characters are now available for name information. The Service encourages full identification of non-resident alien persons and organizations because data is furnished to their governments in accordance with tax treaties.

Element	*Positions*	*Title*	*Description*
15	235 to 269	Street Address	Enter the recipient's full street address. Valid characters are the same as in the 2nd Name Line except that the percent is not valid. If the street, building, military installation or other name is too long for the 35-character allotment of this element, use the 3rd Name Line as the 1st Street Address Line, and continue on this line as a 2nd Street Address line. This line may be all blank, but only for legitimate reason;

Element	*Positions*	*Title*	*Description*
			for example, if the recipient is from a small town or islet or other place where a town or island name is sufficient to enable mail to be received. Left justify and blank fill.
16	270 to 294	City	Enter the name of City, Town, Village, Municipality or rural place of residence of the recipient. Valid characters are as in street address. Left justify, blank fill. For U.S. military installations enter one of the following: APO New York FPO New York APO San Francisco FPO San Francisco APO Seattle FPO Seattle APO Miami FPO Miami The name of the installation or ship may not be entered here, but should be in the Street Address Line.
17	295 to 309	Province Name	Enter here the name of the Province, Foreign State (but *not* the U.S. State), County, Shire, District, Region, or other political subdivision. For many countries the province (or other political subunit) is an important part of the postal address. For Canada the Province MUST be given here; a Canadian province must be expressed as a two-character code from the Canadian Province Code List below; no other abbreviations may be used, nor may the Canadian Province name be written out in full. If a Province (or other political subunit) is not available, blank fill this element. Valid characters are as in the street address. Left justify, blank fill.

Canadian Provinces and Codes

Province	*Province Code*
Alberta	AB
British Columbia	BC
Labrador	LB
Manitoba	MB
New Brunswick	NB
Newfoundland	NF
Nova Scotia	NS
Northwest Territories	NT
Ontario	ON
Prince Edward Island	PE
Quebec	PQ
Saskatchewan	SK
Yukon Territories	YK

Element	*Positions*	*Title*	*Description*
18	310 to 318	Postal Code	Enter the Foreign or U.S. Postal Code (Zip Code), if available. Withholding Agents should make an effort to obtain postal codes, especially for the following countries: Belgium, Canada, France, Germany, Italy, Spain, Switzerland, Netherlands, and United Kingdom. For U.S. addresses (including all possessions) a Zip Code must be given. All postal codes should be left justified and blank filled. Alphabetic, numeric, and blank characters only are allowed here. Do not omit any blanks that may appear in the Zip Code.

Element	*Positions*	*Title*	*Description*
19	319 & 320	State Code	For all U.S. addresses enter the correct two-letter code as prescribed for Post Office use. The state code *must* be present for all U.S. addresses, including territories and APO/FPO. Leave blank for non-U.S. addresses. See list in Section 4. above.
20	321 to 340	Country Name	Enter the unabbreviated name of the recipient's country. Omit political titles such as "People's Republic Of", "Kingdom Of", etc. Use the English Language name, as opposed to the native language name; for example, use "Finland" and not "Suomi". Leave this field blank for all U.S. addresses, including territories, and APO/FPO. Left justify, blank fill.
21	341 to 342	Income Code	Enter the two digit income code from the following list. Valid range is 01-20. If a given recipient receives more than one kind of income, additional "Q" records must be prepared, since only one income code may be shown per "Q" record.

Income Code List

01 – Interest paid by U.S. obligators – general
02 – Interest on real property mortgages
03 – Interest paid to a controlling foreign corporation
04 – Interest paid by foreign corporations (U.S. Agent)
05 – Interest in tax-free government bond
06 – Dividends paid by U.S. corporation – general
07 – Dividends paid by U.S. subsidiary to foreign parent corporation
08 – Dividends paid by foreign corporations
09 – Capital gains
10 – Industrial royalties
11 – Motion picture or television copyright royalties
12 – Other copyright royalties
13 – Real property income and natural resources royalties
14 – Pensions or annuities
15 – Scholarship or fellowship compensations
16 – Compensations for independent personal services
17 – Compensation for dependent personal services
18 – Compensations for teaching
19 – Compensations during training
20 – Other income (non-personal service compensations).

Element	*Positions*	*Title*	*Description*
22	343-344	Type of Recipient Code	Enter two digit code from the list below. Valid range is 01-10.

Code	*Type of Recipient*
01	Individual
02	Corporation
03	Partnership
04	Fiduciary
05	Nominee
06	Government or International Organization
07	"Tax Exempt" Organization
08	Private Foundation
09	Other
10	Type of recipient unknown

Element	*Positions*	*Title*	*Description*
23	345-355	Gross Income Paid	Enter dollars and cents up to 11 characters. Do not enter decimal point. Zero fill and right justify. An income amount other than zero must be shown. For whole dollar amounts, the cents *must* be shown by zeroes. For example, $1500 should be shown as 00000150000-the first four zeroes are "filler", the last two presents cents.
24	356	Effective Connected Code	Enter "1" if income paid is effectively connected with trade or business within the U.S. Otherwise, enter "0" (zero).
25	357	Exemption Code	Enter one digit according to the list below. Valid range is 1-6.

Code	*Exemption Claim*
1	Form 4224 claiming exemption is filed.
2	Form 1078 (claiming taxation under laws applicable to U.S. residents) is filed.
3	Form 1000 is filed.
4	Any non-IRS form or statement has been filed to claim exemption.
5	Any combination of 1 to 4 has been filed to claim exemption.
6	None of the above, no exemption.

Element	*Positions*	*Title*	*Description*
26	358-359	Rate of Tax	Enter two digit tax rate. Do not use percent signs or decimal points. A valid rate must be shown. Valid rates are 00, 02, 05, 10, 14, 15, 27 and 30. Use 27 for the true tax rate of 27½%. When an effectively connected code of 1 is shown, the rate of tax *must* be 00.
27	360-370	Amount of Tax	Enter in dollars and cents the amount of tax withheld, if any. An amount must be shown if the Rate of Tax is greater than 00, or if income is not otherwise exempt from withholding. Specifications are the same as for Element 23 (Gross Income Paid). Right justify, zero fill.
28	371-381	Amount of Tax Released	Enter the total amount of tax released, if any, in dollars and cents. Specifications are the same as Element 23 (Gross Income Paid). Right justify, zero fill.
29	382-392	Amount of Tax Withheld	Enter the difference between Elements 27 and 28, but not less than zero. If Element 28 is greater than or equal to Element 27, enter zero. Right justify and zero fill.

NOTE: All money fields must be mathematically verified by the transmitter before being sent to the Service.

SEC. 6. WITHHOLDING AGENT "W" RECORD.

Write a "W" Record after the last "Q" Record submitted for a particular Withholding Agent has been written. The "W" Record serves as a summary of the preceding "Q" Record data, and enables the Service to double-check the correctness of information received. Several "W" Records for different withholding agents may appear on the same Transmitter's file; also, the "W" Record may refer to "Q" records on more than one reel, provided all of the preceding "Q" Records are for the same withholding agent. A "W" Record may only be followed by new Recipient "Q" Records for the next Withholding Agent, if any, or by an end of transmission "Y" Record. The "W" Record cannot be followed by a tape mark. Each "W" Record has a fixed length of 388 positions. All elements of data in the "W" Record are required as follows:

Element	*Positions*	*Title*	*Description*
1	1	Record Type	Enter letter "W".
2	2 & 3	Payment Year	Enter the last two digits of the year for which income and withholding are being reported. All recipient "Q" records must report payments for this year *only*. Different tax years may not appear on the same file.
3	4 to 12	EIN	Enter the 9 digits of the Employer Identification Number of the *Withholding Agent*. Omit the hyphen.

Element	*Positions*	*Title*	*Description*
4	13 to 47	Agent Name	Enter the name of the Withholding Agent, up to the limit of 35 characters. Abbreviate as needed, omitting punctuation. Left justify and blank fill.
5	48 to 82	Agent Address	Enter the street address, P.O. Box, or other location of the agent to a limit of 35 characters. Abbreviate as needed, omitting punctuation. Left justify and blank fill.
6	83 to 102	City	Enter the city, town, or other locality name up to the limit of 20 characters. Left justify and blank fill.
7	103 & 104	State	Enter the two-character alphabetic code in the list in Section 4 above.
8	105 to 109	Zip Code	Enter 5 numeric characters for all U.S. addresses (including territories, possessions, and APO/FPO). Zero fill for addresses outside the U.S.
9	110 to 117	"Q" Record Count	Enter the total number of "Q" records for this withholding agent; that is, the total count of "Q" records following the last "W" record, or if this is the first "W" record on the file, the total number of "Q" records since the "T" record. The presence of a "Z" or "T" record does not interrupt the count, which may therefore include consecutive "Q" records on more than one tape reel.
10	118 to 130	Total Gross Amount Paid	Enter the sum of all gross amounts paid in all "Q" records, counted in Element 9 above. Zero fill and right justify. Do not "round off" this total, since it is used as a "hash total" check on the "Q" records.
11	131-143	Total Tax Withheld	Enter the sum of all tax withheld amounts from all "Q" records counted in Element 9 above. Right justify, zero fill. Do not "round off".
12	144-156	Total Tax Released	Enter the sum of all tax released amounts from all "Q" records counted in Element 9 above. Right justify, zero fill.
13	157-169	Total Net Tax Withheld	Enter the sum of all net tax withheld amounts from all "Q" records counted in Element 9, above. The amount in this field must be the numeric difference between Elements 11 and 12, but may not be less than zero.
14	170 to 388	Blanks	Blank fill up to the total of 388 characters.

SEC. 7. END OF REEL "Z" RECORD.

End every reel of a file, except the last reel, with an End of Reel "Z" record. A "Z" record may only appear as the last record of a reel. If records are blocked, the "Z" record must be the last record in the last block on the reel. The "Z" record is identical in format to the "W" record. The "Z" record will replace the "W" record in every case where the "W" record would ordinarily fall last on the reel; that is, when all "Q" records for a particular withholding agent have been completed, and reel-end is reached. The "Z" record may only be preceded immediately by a "Q" record, and may be followed immediately only by a "T" record followed by "Q" records. Elements of the "Z" record differ from the same elements of the "W" record as follows: (1) Element 1 Record Type, will be "Z" instead of "W"; (b) Element 9, Total Number of "Q" records, will include a count of all "Q" records since the last preceding "W" record or "T" record; (c) Elements 10, 11, 12 and 13, will likewise total corresponding amounts on "Q" records since the preceding "W" or "T" record.

SEC. 8. END OF TRANSMISSION "Y" RECORD.

End the last reel on a file with an End of Transmission "Y" Record. The "Y" Record may only be preceded by a "W" Record; it may only be followed by a tape mark or tape mark and a Trailer Label, if used. The "Y" Record will count the total number of withholding agents in the transmission, and the total number of tape reels in the file. The "Y" Record has a fixed length of 388 positions, and all elements listed are required.

Element	*Positions*	*Title*	*Description*
1	1	Record Type	Enter letter "Y".
2	2 to 4	Withhold Agent Count	Enter the total number of withholding agents on this file. This count will be the same as the total of "W" records plus any "Z" record. Right justify and zero fill.
3	5 to 7	Reel Count	Enter the total number of reels for this transmission. Right justify and zero fill.
4	8 to 388	Blanks	Enter 381 blanks.

SEC. 9. EFFECT ON OTHER DOCUMENTS.

This Revenue Procedure supersedes Rev. Proc. 79-20, 1979-1 C.B. 527.

---

26 CFR 601.201: Rulings and determination letters.
(Also Part I, Section 103; 1.103-7.)

Rev. Proc. 82-14

SECTION 1. PURPOSE

The purpose of this revenue is to set forth the circumstances under which the Internal Revenue Service will issue an advance ruling that facilities are not used in the trade or business of a nonexempt person within the meaning of section 103(b)(2)(A) of the Internal Revenue Code.

SEC. 2. BACKGROUND

Section 103(a)(1) of the Code provides that gross income does not include the interest on obligations of a state or political subdivision of a state. Section 103(b)(1) provides that, with certain exceptions, industrial development bonds will not be treated as obligations described in section 103(a)(1). Section 103(b)(2) provides that an obligation is an industrial development bond if (A) a major portion of the proceeds are used in the trade or business of a nonexempt person, and (B) the payment of principal or interest on the obligations is secured by an interest in property used in a trade or business or payments in respect to such property.

Political subdivisions of states frequently issue obligations to finance facilities that are owned by exempt persons described in section 103(b)(3) of the Code. However, the exempt owners sometimes contract with a nonexempt management company for management services in the operation of the facilities. This situation requires consideration of whether the financed facilities are used in the trades or businesses of the nonexempt persons within the meaning of section 103(b)(2)(A). The Service will usually issue a ruling that a facility is not used in the trade or business of the nonexempt person if the conditions set forth in section 3 of this revenue procedure are satisfied.

The operating guidelines published in this revenue procedure are intended only to inform taxpayers and their representatives of existing standards for the issuance of private letter rulings. They do not define, as a matter of law, the circumstances under which a bond issued by a state or political subdivision thereof is an industrial development bond within the meaning of section 103(b)(2) of the Code. Thus, the operating guidelines are not to be applied in the examination of taxpayers' returns as tests for determining the taxability of bond interest.

The authority and general procedures of the National Office and the Offices of the District Directors of the Internal Revenue Service for the issuance of advance rulings and determination letters are outlined in Rev. Proc. 80-20, 1980-1 C.B. 633, as modified, clarified, and amplified by Rev. Proc. 81-33, 1981-2 C.B. 564, and section 601.201 of the Statement of Procedural Rules (26 CFR section 601.201 (1980)). Also see Rev. Proc. 79-4, 1979-1 C.B. 483, as amplified by Rev. Proc. 79-12, 1979-1 C.B. 492, as amplified by Rev. Proc. 80-1, 1980-1 C.B. 579; and Rev. Proc. 81-10, 1981-1 C.B. 647. Careful attention to all the requirements of these documents will help prevent delays in processing requests for rulings.

SEC. 3. OPERATING GUIDELINES

A ruling usually will be issued that facilities are not used in the trade or business of a nonexempt person within the meaning of section 103(b)(2)(A) of the Code (relating to the determination of whether the bonds issued by a state or political subdivision thereof to finance the facilities will be industrial development bonds) when the facilities are to be managed by a nonexempt management company, if the following conditions are met:

.01 Except as provided in section 3.02 below, any management contract must provide for compensation for the management services that is based on a periodic flat fee that is reasonable in relation to the services performed. If the contract provides for automatic increases in the periodic flat fee, the increases may not exceed the percentage increases determined by the particular external standards for computing such increases that are mutually agreed upon in the contract. The percentage increases reflected in the Consumer Price Index compiled by the Bureau of Labor Statistics, U.S. Department of Labor, illustrate one standard that may be used. The term of any management contract (including any renewal option periods provided for in the contract) between the owner of the facilities and the management company may not exceed a period of 5 years. If the term of the contract (including any renewal option periods) exceeds 2 years, the owner must be able to cancel the contract without penalty at the end of each 2-year period of the contract term. The owner and the management company must represent that if any new contract is negotiated, the new contract will be subject to the same terms as those described above.

.02 If the facilities financed with bond proceeds have not been operated for a sufficient period to establish with reasonable certainty the amount of the annual gross revenues and expenses, the management contract may provide for compensation for the management services based on a percentage of the gross revenues from the facilities. "Gross revenue" means the total revenue received from the operation of the facilities. However, the term of the percentage compensation arrangement generally may not exceed 1 year. At the end of the 1-year term, any management contract must provide for compensation to be based on a periodic flat fee as described in section 3.01 above.

.03 If the exempt owner of the facilities and the nonexempt management company enter into a contract described in section 3.01 or 3.02 and the governing body of the exempt owner numbers 5 or more members, one member of the governing body of the exempt owner may be an employee or member of the governing body of the management company. Similarly, if the governing body of the management company number 5 or more members, one of those members may be an employee or member of the governing body of the exempt owner of the facilities. However, the employee or member of the governing body of the management company may not serve as the chief executive of the governing body of the exempt owner, and the employee or member of the governing body of the exempt owner may not serve as the chief executive of the governing body of the management company. Members of the governing body of the exempt owner of the facilities may not own a controlling interest in the management company.

SEC. 4. INQUIRIES

Inquiries regarding this revenue procedure should refer to its number and should be addressed to the Assistant Commissioner (Technical), Attention: T:I:I, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

---

26 CFR 601.201: Rulings and determination letters.
(Also Part I, Section 103; 1.103-7.)

Rev. Proc. 82-15

SECTION 1. PURPOSE

This revenue procedure sets forth the conditions that must be met for the Internal Revenue Service to issue an advance ruling that certain facilities are not used in the trade or business of a nonexempt person within the meaning of section 103(b)(2)(A) of the Internal Revenue Code.

SEC. 2. BACKGROUND

Section 103(a)(1) of the Code provides that gross income does not include the interest on obligations of a state or political subdivision of a state. Section 103(b)(1) provides that, with certain exceptions, industrial development bonds will not be treated as obligations described in section 103(a)(1). Section 103(b)(2) provides that an obligation is an industrial development bond if (A) a major portion of the proceeds are used in the trade or business of a nonexempt person, and (B) the payment of principal or interest on the obligations is secured by an interest in property used in a trade or business or payments in respect to such property.

Political subdivisions of states frequently issue obligations to finance hospitals, nursing homes, or similar facilities that are owned and operated by exempt persons described in section 103(b)(3) of the Code. Such facilities are sometimes used by physicians, professional corporations, or other nonexempt persons who are not employees of the exempt persons. This situation requires consideration of whether the financed facilities are used in the trades or businesses of the nonexempt persons within the meaning of section 103(b)(2)(A). The Service will usually issue a ruling that a facility is not used in the trade or business of the nonexempt person if the conditions set forth in section 3 of this revenue procedure are satisfied.

The operating guidelines published in this revenue procedure are intended only to help taxpayers and their representatives prepare ruling requests. These guidelines are intended to reflect the current position of the Service on the issuance of rulings. They do not define, as a matter of law, the circumstances under which a bond issued by a state or its political subdivision is considered an industrial development bond under section 103(b)(2) of the Code. Thus, the operating guidelines are not to be applied in the examination of taxpayers' returns as tests for determining the taxability of bond interest.

The authority and general procedures of the National Office and the Offices of the District Directors of the Internal Revenue Service for issuing advance rulings and determination letters are outlined in Rev. Proc. 80-20, 1980-1 C.B. 633, as modified, clarified, and amplified by Rev. Proc. 81-33, 1981-2 C.B. 564, and in section 601.201 of the Statement of Procedural Rules (26 CFR section 601.201 (1980)). Also see Rev. Proc. 79-4, 1979-1 C.B. 483, as amplified by Rev. Proc. 79-12, 1979-1 C.B. 492, as amplified by Rev. Proc. 80-1, 1980-1 C.B. 579; and Rev. Proc. 81-10, 1981-1 C.B. 647. Careful attention to all the requirements of these documents will help prevent delays in processing requests for rulings.

SEC. 3. OPERATING GUIDELINES

The Service will usually rule that if the conditions listed below are met, facilities that are owned by an exempt person and used by a nonexempt person are not considered used in the trade or business of the nonexempt person within the meaning of section 103(b)(2)(A) of the Code. The conditions are the following:

.01 If any contract between the exempt person and the nonexempt person provides for compensation based on a percentage of fees charged for services rendered by the nonexempt person, the contract may not exceed a term of 2 years. In addition, the exempt person must be able to cancel the contract without penalty or cause by giving the nonexempt person 90 days' notice. The compensation must be reasonable, and it may not be based on a percentage of the net profits of the exempt person or a division of the exempt person. The exempt person and the nonexempt person must represent that any new percentage-of-fee contract they negotiate will also be subject to these terms.

.02 If any contract between the exempt person and the nonexempt person provides for compensation based on a periodic flat fee, the compensation must be reasonable and the contract may not exceed a term of 5 years. In addition, the exempt person must be able to cancel the contract without penalty or cause at the end of each 2-year period of the contract term. If the contract provides for automatic increases in the periodic flat fee, the increases may not exceed the percentage increases determined by the particular external standards for computing such increases that are mutually agreed upon in the contract. The percentage increases reflected in the Consumer Price Index compiled by the Bureau of Labor Statistics, U.S. Department of Labor, or the actual percentage increases for services that result from the application of external criteria (for example, increases in rates paid by insurance companies) are illustrations of two external standards that may be used. The exempt person and the nonexempt person must represent that any new flat-fee contract they negotiate will also be subject to these terms.

.03 If a nonexempt person and an exempt person enter into a contract described in section 3.01 or 3.02 and the governing body of the exempt person numbers 5 or more members, one member of the governing body of the exempt person may be the nonexempt person or related person (as described in section 103(b)(6)(C) of the Code), an employee of the nonexempt person, or a member of the governing body of the nonexempt person. However, such nonexempt person, employee of the nonexempt person, or member of the governing body of the nonexempt person may not serve as the chief executive of the governing body of the exempt person.

SEC. 4. INQUIRIES

Inquiries about this revenue procedure should refer to its number and should be addressed to the Assistant Commissioner (Technical), Attention T:I:I, Internal Revenue Service, 1111 Constitution Ave., N.W., Washington, D.C. 20224.

---

26 CFR 601.201: Rulings and determination letters.
(Also Part I, Sections 103A, 6103; 6a.103A-2, 301.6103(c)-1.)

Rev. Proc. 82-16

SECTION 1. PURPOSE

The purpose of this revenue procedure is to set forth procedures for requesting certain income tax returns or income tax return information described in section 6a.103A-2(c)(1)(ii) of the Temporary Income Tax Regulations (concerning mortgage subsidy bonds) published in the Federal Register on July 1, 1981 (46 FR 34311), 1981-2 C.B. 25, as amended November 10, 1981 (46 FR 55513), 1981-2 C.B. 40.

SEC. 2. BACKGROUND

.01 Section 103(a) of the Internal Revenue Code provides that gross income does not include interest on (1) the obligations of a state or political subdivision of a state, and (2) qualified scholarship funding bonds.

.02 Section 103A was added to the Code by the Mortgage Subsidy Bond Tax Act of 1980, Pub. L. 96-499, 1980-2 C.B. 509, 512. Section 103A(a) provides that, with certain exceptions, any mortgage subsidy bond will be treated as an obligation not described in section 103(a)(1) or (2). A mortgage subsidy bond is an obligation that is issued as part of an issue a significant portion of the proceeds of which is to be used directly or indirectly to provide mortgages on owner-occupied residences.

.03 Section 103A(b)(2)(A) of the Code provides that any "qualified mortgage bond" will not be treated as a mortgage subsidy bond. A qualified mortgage bond is an obligation issued as part of a "qualified mortgage issue." A qualified mortgage issue is an issue by a state or political subdivision of a state of one or more obligations in which all proceeds of the issue (exclusive of issuance costs and a reasonably required reserve) are to be used to finance owner-occupied residences and the issue meets the requirements of subsections (d), (e), (f), (g), (h), (i), and (j) of section 103A.

.04 An issue meets the requirements of subsection (e) of section 103A of the Code and section 6a.103A-2(e) of the temporary regulations if each mortgagor to whom financing is provided under the issue had no present ownership interest in a principal residence at any time during the 3-year period prior to the date the mortgage is executed.

.05 Section 6a.103A-2(c)(1) of the temporary regulations provides that an issue of qualified mortgage bonds that fails to meet one or more of the eligibility requirements of paragraphs (d), (e), (f), and (j) of section 6a.103A-2 will be treated as meeting such requirements if each of the following provisions is met: (i) The issuer in good faith attempted to meet all such requirements before the mortgages were executed; (ii) Ninety-five percent or more of the lendable proceeds that were devoted to owner financing were devoted to residences with respect to which, at the time the mortgages were executed or assumed, all such requirements were met; (iii) Any failure to meet such requirements is corrected within a reasonable period after such failure is discovered.

.06 Section 6a.103A-2(c)(1)(ii) of the temporary regulations provides that an issuer will be deemed to have satisfied the 95 percent test if the issuer relies on an examination by the issuer or loan originator, on behalf of the issuer, of each mortgagor's copies of income tax returns that indicate, for the preceding 3 years, the mortgagor did not claim deductions for taxes or interest on indebtedness with respect to real property that was the mortgagor's principal residence. The mortgagor must also provide the issuer or loan originator with an affidavit that the requirements of section 6a.103A-2(e) and (f) are met. Copies of the income tax returns may be provided by the mortgagor or obtained by the issuer or loan originator in accordance with the procedures set forth in section 301.6103(c)-1 of the Regulations on Procedure and Administration.

.07 The facts in Example (1) of section 6a.103A-2(c)(1)(iv) of the temporary regulations indicate that a bank obtains copies *certified* by the Service of the loan applicant's federal tax returns for the preceding 3 years and examines each return to determine of the applicant has claimed a deduction for taxes and interest with respect to real property that was the applicant's principal residence. In addition, the issuer, in order to satisfy the requirements of section 6a.103A-2(c)(1)(i), establishes procedures for ensuring compliance with the requirements of section 103A of the Code, and the relevant documents contain restrictions that permit financing only in accordance with such requirements. Example (1) states that these facts are sufficient evidence of good faith of the issuer and meet the requirements of section 6a.103A-2(c)(1)(i) and (ii). The facts in Example (4) of section 6a.103A-2(c)(1)(iv) indicate that the issuer requires copies of the applicant's signed tax returns that were filed with the Service for the preceding 3 years, but does not require that such returns be certified. Example (4) concludes that if 95 percent of the lendable proceeds are devoted to owner financing that according to the procedures meet the requirements of paragraphs (d), (e), (f), and (i) of section 6a.103A-2, then the issue meets the requirements of section 6a.103A-2(c)(1)(ii).

.08 Section 301.6103(c)-1 of the regulations provides that a taxpayer may request that a return or return information be disclosed to a person designated in a written request for or consent to disclosure. The written document must be signed and dated by the taxpayer who filed the return or to whom the return information relates. The taxpayer must indicate in the written document the following:

(1) The taxpayer's name, mailing address, and taxpayer identifying number;

(2) The identity of the person to whom disclosure is to be made;

(3) The type of return (or specified portion of the return) or return information that is to be disclosed; and

(4) The taxable year covered by the return or return information. Form 4506, Request for Copy of Tax Form, should be used for requesting copies of tax returns or tax return information.

.09 Form 1040A, U.S. Individual Income Tax Return, does not provide for the deduction of itemized deductions (such as taxes and interest attributable to a taxpayer's principal residence) for purposes of computing taxable income. Therefore, an examination of a loan applicant's copy of Form 1040A will indicate that the applicant did not claim taxes or interest attributable to a principal residence.

.10 The Service has become aware that some uncertainty exists among issuers of qualified mortgage subsidy bonds and loan originators with respect to the type of copy of the loan applicant's federal income tax return that must be examined and the manner in which such copy is to be obtained.

SEC. 3. PROCEDURE

.01 Examination by an issuer or loan originator of a mortgagor's retained signed copies of the mortgagor's federal income tax returns filed with the Service for the 3 tax years immediately preceding the date the mortgage is executed will satisfy the 95-percent test under section 6a.103A-2(c)(1)(ii) of the temporary regulations. The mortgagor is also required to provide an affidavit that the other requirements of section 6a.103A-2 are met.

.02 In those situations where a mortgagor did not retain signed copies of the federal income tax returns filed with the Service, copies may be obtained from the Service upon submission of a written request by the mortgagor that complies with the requirements of section 301.6103(c)-1 of the regulations. Form 4506, Request for Copy of Tax Form, may be used to request such returns. When requesting that copies of the tax returns be mailed to the issuer or loan originator, the name of a designated individual recipient for the issuer or loan originator must be included with the mailing address. The reference in Example (1) of section 6a.103A-2(c)(1)(iv) to copies *certified* by the Service was intended to illustrate one type of copy that may be used for examination. It was not intended to establish any advantage to the examination of *certified* copies. Further, neither the examination of *certified* returns nor the examination of uncertified returns, in and of itself, meets the requirements of sections 6a.103A-2(c)(1)(i) or 6a.103A-2(c)(1)(ii).

.03 If a mortgagor filed Form 1040A but did not retain a signed copy of the return, the issuer or loan originator may satisfy the requirement that it examined copies of the mortgagor's returns to determine that the mortgagor did not claim deductions for taxes or interest on indebtedness with respect to real property that was the mortgagor's principal residence by obtaining a letter from the Service that the mortgagor filed Form 1040A for the year or years in question. The written request for return information (signed by the mortgagor) must state that if a Form 1040A was filed, such information is to be furnished to the individual designated to receive the information for the issuer or loan originator and that a copy of the return is not to be mailed. If Form 4506 is used, the words "Form 1040A Notification Requested" should be written across the top of the form. A statement should be included in the appropriate items on the form indicating that a letter verifying filing of Form 1040A is requested rather than a photocopy of the Form 1040A. It is anticipated that the Service will be able to process a request for a letter indicating that a taxpayer filed a Form 1040A in a significantly shorter period of time than a request for a copy of the taxpayer's income tax return.

.04 If a mortgagor did not retain a copy of the income tax return filed with the Service and does not recall whether a Form 1040A or Form 1040 was filed, the procedures set forth in section 3.03 of this revenue procedure should be followed in preparing a request for the income tax return information. In addition, a statement should be included in the request that in the event the taxpayer filed a Form 1040, a copy of that return is to be mailed to the person designated to receive the information or copy of the tax return for the issuer or loan originator.

---

26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also Part I, Section 4071, 48.4071-2)

Rev. Proc. 82-17

SECTION 1. PURPOSE

The purpose of this revenue procedure is to amplify Rev. Proc. 80-19, 1980-1 C.B. 628, which specifies the method that tire manufacturers, producers, and importers must use if they want to determine tire and inner tube weights on an average-weight basis for the purpose of computing the manufacturers excise tax imposed by section 4071(a) of the Internal Revenue Code.

SEC. 2. BACKGROUND

.01 Section 4071 of the Code imposes an excise tax on the sale by the manufacturer, producer or importer of tires and inner tubes, computed on their total weight.

.02 Section 48.4071-2(b) of the Manufacturers and Retailers Excise Tax Regulations provides that a manufacturer, producer, or importer who has received permission from the Commissioner, subject to the conditions prescribed by the Commissioner, may determine total weight of tires and inner tubes on the basis of the average weight of each type, size, grade, and classification shown in schedules published by the tire industry.

.03 Section 48.4071-2(b) of the regulations does not set forth a specific method for computing average weight. Rev. Proc. 80-19 prescribes the conditions under which manufacturers, producers, and importers may use the industry schedule of average weights. It also prescribes the method by which the industry schedule is compiled.

.04 Rev. Proc. 80-19 requires manufacturers, producers and importers who receive permission to use the industry schedule to submit annually to the industry group specification weights and production figures for the preceding fiscal year (as defined in the revenue procedure). The revenue procedure further requires verification of the specification weights during the current fiscal year by the taking of a ten-tire sample.

.05 It has come to the attention of the Service that manufacturers, producers, and importers are able to provide adequate verification of specification weights by methods other than the ten-tire sample prescribed in Rev. Proc. 80-19.

SEC. 3. APPLICATION

.01 Manufacturers, producers, and importers who determine their manufacturers excise tax liability for tires and tubes on the basis of average weight under the provisions of Rev. Proc. 80-19 may apply to the Service for permission to verify specification weights by a method other than the specific method (ten-tire sample) prescribed in Rev. Proc. 80-19.

.02 This application must be in the form of a request for a ruling, following the procedures described in Rev. Proc. 80-20, 1980-1 C.B. 633, as modified, clarified, and amplified by Rev. Proc. 81-33, 1981-2 C.B. 564.

.03 Upon approval, the manufacturer, producer or importer must submit a copy of the ruling to the industry group.

SEC. 4. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 80-19 is amplified.

SEC. 5. EFFECTIVE DATE

This revenue procedure is effective June 23, 1980, publication date of Rev. Proc. 80-19.

---

26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 82-18

SECTION 1. BACKGROUND

Rev. Proc. 81-10, 1981-1 C.B. 647, sets forth areas in which advance rulings or determination letters will not be issued by the Internal Revenue Service. Section 5 of Rev. Proc. 81-10 is entitled, Areas Under Extensive Study in Which Rulings or Determination Letters Will Not Be Issued Until the Service Resolves the Issue Through Publication of a Revenue Ruling, Revenue Procedure, Regulations or Otherwise.

SEC. 2. PROCEDURE

Rev. Proc. 81-10 is hereby amended by adding to section 5 the following new section:

Section 422A.—Incentive Stock Options.—Whether Holding (1) of Rev. Rul. 80-244, 1980-2 C.B. 234, relating to section 1036, applies to incentive stock options.

SEC. 3. EFFECTIVE DATE

This revenue procedure will apply to all ruling requests on hand in the National Office on March 15, 1982, the date of publication of this revenue procedure in the Internal Revenue Bulletin, as well as to requests received thereafter.

SEC. 4. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 81-10 is amplified.

---

26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part I, Sections 166, 446, 481; 1.166-4, 1.446-1, 1.481-1.)

Rev. Proc. 82-19

SECTION 1. PURPOSE

.01 The purpose of this revenue procedure is to provide a procedure whereby taxpayers may expeditiously obtain consent to change their method of accounting for deducting bad debts from the specific charge-off method as provided in section 166(a) of the Internal Revenue Code to the reserve method as provided in section 166(c). Taxpayers complying with this revenue procedure will be deemed to have obtained the consent of the Commissioner of Internal Revenue to change to the reserve method for deducting bad debts.

.02 This revenue procedure supersedes Rev. Proc. 64-51, 1964-2 C.B. 1003, as amplified and modified by Rev. Proc. 70-15, 1970-1 C.B. 441, and Rev. Proc. 77-39, 1977-2 C.B. 573.

SEC. 2. BACKGROUND

.01 Section 446(e) of the Code and section 1.446-1(e) of the Income Tax Regulations provide that in order to change a method of accounting for federal income tax purposes, the taxpayer must obtain the consent of the Commissioner. Section 1.446-1(e)(3)(i) requires that in order to obtain the consent, an application, Form 3115, Application for Change in Accounting Method, must be made within 180 days after the beginning of the tax year in which the proposed change is requested to be made. Section 1.446-1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the limitations, terms, and conditions deemed necessary to permit a taxpayer to obtain consent to a change in its method of accounting in accordance with section 446(e).

.02 Section 481(a) of the Code requires that those adjustments necessary to prevent amounts from being duplicated or omitted be taken into account when the taxpayer's taxable income is computed under a method of accounting different from the method used to compute taxable income for the preceding tax year. Section 481(c) and section 1.481-5 of the regulations provide that the adjustment required by section 481(a) may be taken into account in determining taxable income in the manner and subject to the conditions agreed to by the Commissioner and the taxpayer.

.03 Under Rev. Proc. 64-51, as amplified and modified by Rev. Proc. 70-13 and Rev. Proc. 77-39, a taxpayer could expeditiously change its method of accounting for bad debts from the specific charge-off method to the reserve method by filing an application on Form 3115 with the Commissioner within 180 days after the beginning of the tax year in which the change is to be effected (year of change). Under the above cited revenue procedure, unless a letter was received by the taxpayer from the Commissioner denying permission to change to the reserve method because the Form 3115 was not timely filed it could be assumed by the taxpayer that the change had been granted and the taxpayer was required to attach a copy of the Form 3115 to the income tax return filed for the tax year of change. Taxpayers had to comply with all the specific conditions of Rev. Proc. 64-51, as amplified and modified, for the change to be deemed to have been made with the consent of the Commissioner.

SEC. 3. CHANGES

.01 This revenue procedure contains several major changes and amplifications in the procedures for obtaining the Commissioner's consent to a change in method of accounting for bad debts from the specific charge-off method to the reserve method. These changes and amplifications are intended to facilitate the manner in which the change can be affected as well as to update Rev. Proc. 64-51 to include many of the basic requirements of Rev. Proc. 80-51, 1980-2 C.B. 818. Rev. Proc. 80-51 contains the general procedures for changing a method of accounting. This section highlights the major changes and amplifications for processing bad debt cases.

.02 Section 4.01 waives the 180 day rule of section 1.446-1(e)(3)(i) of the regulations and grants consent to taxpayers to change their method of accounting in accordance with the provisions of this revenue procedure by filing a current Form 3115 in the manner described in section 8 of this revenue procedure and by otherwise complying with the provisions of this revenue procedure.

.03 Section 4.02 provides that the initial reserve for bad debts (the adjustment under section 481 of the Code or the "section 481(a) adjustment") is computed as of the beginning of the year of change. Under Rev. Proc. 64-51 taxpayers were permitted to compute the initial reserve as of the end of the year of change.

.04 Section 4.04 provides how the appropriate period for taking into account the section 481(a) adjustment is determined. Under Rev. Proc. 64-51 the adjustment was always taken into account ratably over 10 years.

.05 Section 4.08 provides that taxpayers that change from the specific charge-off to the reserve method for bad debts must keep their books and records for the year of change and for later tax years on the reserve method. Taxpayers, other than those discussed in section 4.12, must use the reserve method for all reports to shareholders, financial statements and statements for credit purposes.

.06 Section 4.11 provides that to the extent the portion of the negative section 481(a) adjustment to be taken into account in the year of change creates or increases an existing net operating loss, that amount may not be carried back to earlier tax years but must be carried forward to later tax years.

.07 Section 8.01 sets forth procedures taxpayers are to follow to receive the Commissioner's consent under this revenue procedure. The current Form 3115 is to be filed in duplicate; the original is to be filed with the taxpayer's timely filed federal income tax return filed for the year of change and the copy is to be sent to the National Office anytime during the first 270 days of the year of change. Thus, taxpayers are required to notify the National Office of their intention to invoke the provisions of this revenue procedure prior to the filing of their federal income tax return for the year of change.

SEC. 4. APPLICATION

.01 In accordance with section 1.446-1(e)(3)(ii) of the regulations the 180 day rule is waived and under section 1.446-1(e)(2)(i) consent is hereby granted to taxpayers to change from the specific charge-off method of accounting to the reserve method of accounting for bad debts. Consent to change is granted for the tax year for which the taxpayer requests a change (year of change) by filing a current Form 3115 for the year of change in accordance with section 8 of this revenue procedure and by otherwise complying with the provisions of this revenue procedure.

.02 An adjustment computed as of the beginning of the year of change is required under section 481(a) of the Code and the regulations thereunder when the change in method of accounting is made under the provisions of this revenue procedure. The amount of the adjustment is the amount of a reasonable reserve for bad debts that the taxpayer would have had as of the end of the tax year immediately preceding the year of change and represents a decrease in income. The adjustment, which is negative, referred to as the "section 481(a) adjustment" shall be taken into account in computing taxable income and in computing earnings and profits (see Rev. Proc. 79-47, 1979-2 C.B. 528, as to earnings and profits) as provided in 4.04 below. The approved change shall be considered to be a voluntary change initiated by the taxpayer.

.03 The amount of the section 481(a) adjustment shall be an amount determined by dividing total net losses on bad debts (bad debt losses less bad debt recoveries) for the 5 tax years preceding the tax year of change (or the number of years in existence if less than 5 tax years) by the sum of the amount of outstanding trade receivables at the close of those tax years used above, and then multiplying the amount of outstanding trade receivables at the close of the tax year preceding the year of change by the resulting decimal amount. If the taxpayer is a member of an affiliated group and more than one member of the group is requesting to change to the reserve method of deducting bad debts, the section 481(a) adjustment must be computed and separately stated for each taxpayer.

.04 1 The appropriate period for taking into account the section 481(a) adjustment referred to in section 4.02 (adjustment period) is generally determined as follows:

(a) When the entire amount of the section 481(a) adjustment is attributable to the tax year immediately preceding the year of change (first preceding year), the total section 481(a) adjustment is to be taken into account in computing taxable income for the year of change. The amount attributable to the tax year immediately preceding the year of change is the difference in the amount of the adjustment determined under section 481(a) of the Code for the year of change and the amount of the adjustment that would have been required under section 481(a) if the same change in method of accounting had been made in the first preceding year.

(b) When (a) does not apply and 67 percent or more of the amount of the section 481(a) adjustment is attributable to the 1-tax year period, 2-tax year period, or 3-tax year period immediately preceding the year of change, the highest percent attributable to the 1, 2, or 3-tax year period is to be taken into account ratably over a 3-tax year period beginning with the year of change. Any remaining balance is to be taken into account ratably over an additional period equal to the remainder of the number of tax years the taxpayer has used the method of accounting that is being changed. However, the total adjustment period shall not exceed 10 tax years. This subparagraph, 4.04 1(b), only applies if the taxpayer has used the method being changed for more than 3 tax years. If the method of accounting being changed has been used for no more than 4 tax years, 75 percent shall be substituted for 67 percent. An amount attributable to the 1, 2, or 3-tax year period is the difference in the amount of the adjustment determined under section 481(a) of the Code for the year of change and the amount that would have been required under section 481(a) if the same change had been made at the beginning of the preceding 1, 2, or 3-tax year period.

(c) In all other situations in which (a) and (b) above do not apply, the total section 481(a) adjustment will be taken into account ratably over the number of tax years (not to exceed 10) the taxpayer has used the method of accounting that is being changed.

2 In applying section 4.04 1 if a taxpayer's books and records do not contain sufficient information to compute the section 481(a) adjustment attributable to the 1, 2, or 3-tax year period immediately preceding the year of change, the taxpayer may reasonably estimate the amounts and also attach and sign the following statement to the Form 3115:

Under penalty of perjury, I hereby certify that:

(a) the books and records of [name of the taxpayer] to not contain sufficient information to permit a computation of the section 481(a) adjustment attributable to the 1-tax year period, 2-tax year period, or 3-tax year period immediately preceding the year of change as required by section 4.04 1(b) of Rev. Proc. 82-19.

(b) Based on the information that is contained in such records, to the best of my information and belief, the entire amount of the section 481(a) adjustment for the year of change [indicate either "*is*" or "*is not*," as the case may be] attributable to the tax year immediately preceding the year of change, and 67 percent or more [or "75 percent," in applicable cases] or more of the section 481(a) adjustment for the year of change [indicate "*is*" or "*is not*," as the case may be] attributable to the 1-tax year period, 2-tax year period, or 3-tax year period immediately preceding the year of change.

.05 For an example of the application of the rules prescribed in section 4.04 1 with respect to the appropriate period for taking into account the section 481(a) adjustment see Example A in section 5.13 of Rev. Proc. 80-51.

.06 The amount of the bad debt deduction for the year of change and tax years thereafter will consist of the reasonable addition to the reserve for bad debts for each year as provided by section 166(c) of the Code plus any amount of the section 481(a) adjustment determined in accordance with section 4.03 above required to be taken into account during the adjustment period.

.07 Ceasing to engage in the trade or business.

(a) With respect to a corporation:

If a corporate taxpayer ceases to engage in the trade or business, to which the section 481(a) adjustment (sections 4.02 and 4.03) relates, at any time prior to the expiration of the adjustment period referred to in section 4.04, the taxpayer shall take into account in that year the balance of the adjustment not previously taken into account in computing taxable income. See Rev. Rul. 80-39, 1980-1 C.B. 112, which holds that if a division of a corporation, for which a change in method of accounting had been granted, ceases to operate the trade or business for which the change in method was granted, the remaining section 481(a) adjustment applicable to the business conducted by that division of the corporation must be taken into income in the year the corporation ceases to engage in that trade or business. For purposes of this condition, the taxpayer is not considered to have ceased the trade or business if the with the Commissioner of Internal Revenue, Attention: T:C:C:1, 1111 Constitution Avenue, N.W., Washington DC, 20224, within the 180 day period prescribed by the regulations. These taxpayers must comply with Rev. Proc. 80-51.

SEC. 6. RECORDS

Taxpayers must maintain adequate records so that the Service may, upon examination, verify the data concerning the change in method of accounting.

SEC. 7. COMPLIANCE WITH CONDITIONS

Taxpayers making a change from the specific charge-off method to the reserve method of accounting for bad debts without complying with all the conditions of this revenue procedure will be deemed to have initiated the change without obtaining the consent of the Commissioner.

SEC. 8. MANNER OF EFFECTING THE CHANGE

.01 Taxpayers to which this revenue procedure applies must effect the change in their methods of accounting pursuant to the provisions set forth in this revenue procedure by filing a current Form 3115 in duplicate. The original shall be attached to the taxpayer's timely filed federal income tax return for the year of change. A copy of the current Form 3115 shall be filed with the National Office addressed to the Commissioner of Internal Revenue, Attention: T:C:C:1, 1111 Constitution Avenue, N.W., Washington, DC 20224, no later than 270 days after the beginning of the tax year of change. The Service will acknowledge the receipt of the copy of the Form 3115 by return mail. A copy of the acknowledgment is to be attached by the taxpayer to the taxpayer's federal income tax return for the year of change. In addition to providing all of the information required on the current Form 3115, the taxpayer must state that it proposes to take the section 481(a) adjustment into account over the appropriate period required by section 4.04. The National Office will sample the Forms 3115 to determine whether the requirements of this revenue procedure have been followed. Also, where it is found that the taxpayer does not qualify for the automatic change in method of accounting under this revenue procedure, the National Office or the district director will advise the taxpayer.

.02 In order to assist in the processing of these changes in methods of accounting and to insure proper handling, reference to this revenue procedure shall be made a part of the Form 3115 by either typing or legibly printing the following statement at the top of page 1 of Form 3115: "FILED UNDER REV. PROC. 82-19."

.03 The signature of the individual or person preparing the application for the taxpayer must appear in the space at the bottom of page 1 on the Form 3115. An application made by an agent on behalf of a taxpayer must be accompanied by a power of attorney authorizing the agent to sign for the taxpayer. If the agent is also authorized to represent the taxpayer before the Service, receive the original or a copy of correspondence concerning the request, or perform any other act(s) regarding the application on behalf of the taxpayer, the power of attorney must reflect such authorization(s). If the taxpayer is a member of an affiliated group that has elected to file a consolidated federal income tax return, a Form 3115 submitted on behalf of the taxpayer must be signed by a duly authorized officer of the common parent. (See section 1.1502-77 of the regulations.)

SEC. 9. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 64-51, Rev. Proc. 70-15, and Rev. Proc. 77-39, are superseded.

SEC. 10. EFFECTIVE DATE

This revenue procedure shall be effective for applications, Forms 3115, filed for tax years ending after March 15, 1982, the date of its publication in the Internal Revenue Bulletin.

SEC. 11. INQUIRIES

Inquiries in regard to this revenue procedure should refer to its numbers and be addressed to the Commissioner of Internal Revenue, Attention: T:C:C:1, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

---

26 CFR 601.401: Employment taxes.
(Also Part I, Sections 3121, 3231; 31.3121(a)(2)-1, 31.3231(e)-1.)

Rev. Proc. 82-20 [1]

SECTION 1. PURPOSE

The purpose of this revenue procedure is to provide questions and answers about the taxability of sick pay under the Federal Insurance Contributions Act and the Railroad Retirement Tax Act.

SEC. 2 BACKGROUND

Pub. L. 97-123, page 314, this Bulletin, amended sections 3121(a)(2) and 3231(e) of the Internal Revenue Code regarding sick pay and disability payments. The first six months of sick pay paid to an employee on or after January 1, 1982, are subject to social security (FICA) and railroad retirement taxes. The following series of questions and answers explains some of the amendments made by Pub. L. 97-123.

SEC. 3 QUESTIONS AND ANSWERS

1. Q. With the changes made by Pub. L. 97-123 are all sickness or accident benefits paid by an employer or third party to or on behalf of an employee, taxable under FICA?

   A. No, there are several exceptions:

   (1) Benefits paid under a qualified plan as described in section 3121(a)(2) of the Internal Revenue Code, that makes provision for employees generally or for a class or classes of employees (and dependents if covered), if paid under a statute in the nature of a workmen's compensation act are not taxed.

   (2) The portion of any benefit attributable to an employee's contribution towards the payment of accident and disability insurance premiums is not taxed.

   (3) The payments made after the expiration of 6 calendar months following the last calendar month in which the employee worked for the employer, are not taxed. This exception, contained in section 3121(a)(4) of the Code is not affected by the changes made by Pub. L. 97-123.

   (4) There is also a limited exception applying to benefits paid by certain third parties. Such benefits will not be taxed under FICA under the following conditions:

---

[1] Also released as News Release IR-82-34, dated March 4, 1982.

—The third party entered into a contractual relationship with the employer before December 14, 1981, under which the benefits are paid.

—Coverage by the third party for the employee's group ceases before March 1, 1982.

—No payment by the third party to the employee is made under the contractual relationship after February 28, 1982.

2. Q. For purposes of the new law, what is a "third party"?

A. A third party typically is an insurance company. A third party could also be a trust providing incidental sick and accident benefits as described in section 501(c)(17) of the Code; an employers' association funded to pay sickness and accident benefits; etc.

3. Q. Does Pub. L. 97-123 change how sickness or accident benefits are taxed under the income tax provisions?

A. No.

4. Q. What is the effective date of the new provisions?

A. The new provisions apply to remuneration paid after December 31, 1981. In the case of an employee who is not working and is receiving employer or third party sickness or accident benefits, the December 31, 1981 effective date does not mean that the 6 calendar months referred to in the answer to question 1 begin to run on January 1, 1982. On the contrary, if the 6 calendar month period has expired, the employee's benefits will not be taxed. So if the 6 calendar month period has expired on December 31, 1981 or earlier, remuneration paid on or after January 1, 1982 will not be taxed.

5. Q. When sickness and accident benefits are paid to or for an employee by a third party, what are the third party's tax responsibilities?

A. The third party is treated as a separate employer and is required to withhold and deposit the FICA tax, reflecting the amount deposited in its own Employer's Quarterly Federal Tax Return, Form 941. The third party will also prepare and file the Annual Wage and Tax Statement, Form W-2, and transmittal Form W-3 with the Service (or equivalent computer prepared tape or diskette) and provide the employee with a Form W-2 statement (or equivalent privately printed approved substitute). Form W-3 is being revised to reflect the reconciliation of FICA tax amounts on Form W-2 and Form 941 by these payers.

Notwithstanding these requirements, the third party will be relieved of the liability and the employer will be charged with the liability of paying the employer portion of FICA tax and for meeting the Form W-3 and Form W-2 requirements if the third party fulfills each of the following promptly: withholds the employee portion of the tax; meets the required due date for depositing the tax; and notifies the employer of the amount of wages involved. Pending the issuance of further Service guidance; (1) the notification requirement will be deemed to have been met if the third party notification is furnished within 2 working days after the day of deposit, and (2) similarly, for purposes of determining its own deposit due date on the employer portion of the tax, the employer will be deemed to have made payment to the employee on the 2nd work day following the third party's deposit of the employee portion of the tax.

6. Q. With regard to 5 above, for administrative convenience, may an employer contract with the third party to have the third party deposit the employer portion of the tax, as well as the employee portion?

A. The employer and third party may enter into such an agreement where the third party acts as an agent for the deposit of the employer portion of tax, and if desired, preparation of the Form W-2 as well. If there is an agreement covering preparation of Forms W-2 the Service does not require the third party and the employer to provide separate Annual Wage and Tax Statements to the employee—one statement reflecting the FICA wage amount paid and tax withheld by the third party, the other statement reflecting the amounts paid and tax withheld by the employer for the period for which the employee is in a working status. The Service will review this matter and if circumstances warrant, provide further guidance as to acceptable deviations from this general rule.

However, if the third party fails to "promptly" withhold and deposit the required tax, the Service will require the third party to be treated as a separate employer. See 5 above.

7. Q. Is any recognition taken in Pub. L. 97-123 for the short lead time before the changes are effective?

A. No penalties or interest will be assessed for failure to make timely payment of FICA taxes for sick pay paid during the period January 1, 1982 through June 30, 1982, to the extent the taxes are attributable to the P.L. 97-123 provisions, and the failure is due to reasonable cause and not to willful neglect and the taxes are paid on or before June 30, 1982. Assuming a reasonable cause for failure to make timely payment exists, the payer nevertheless remains liable for payment of the FICA tax. This means, for example, that a third party may find it necessary to arrange with an employer for the withholding of the employee's share of the FICA tax if the employee has returned to work prior to the start-up of the third party's withholding procedures. The Service encourages taxpayers to set up necessary procedures as soon as possible.

8. Q. Whether or not the third party is treated as a separate employer, it must withhold the employee portion of the tax as sick pay. Could not this result in withholding tax on wages in excess of the FICA base, $32,400 for 1982, in some circumstances?

A. When both the third party and the employer make payments to the employee, the cumulative payments during the year subject to FICA tax could exceed the base. However, the Service contemplates that it will furnish guidance in the near future on procedures to be followed by the appropriate withholding agent, either the third party or the employer.

9. Q. How do the new provisions affect the taxation of sickness and accident disability benefits paid by railroad employers or third parties making payments to railroad employees?

A. Amendments to the Railroad Retirement Tax Act closely follow the above changes in FICA. Sickness and accident disability benefits paid before the end of the six month calendar period (corresponding to the FICA provision – see answer to question 1) are taxed unless the benefits are: received as workmen's compensation; or received under the Railroad Retirement Act of 1974, Pub. L. 93-445, 1974-2 C.B. 440; or the benefits are paid under the Railroad Unemployment Insurance Act for days of sickness to the extent that the sickness is the result of on-the-job injury. Also, the provisions regarding third party payers and their responsibilities, and how they can be relieved of paying and depositing the employer share of RRTA tax and also be relieved of the Form W-2 responsibilities, follow the FICA provisions discussed above. In addition, the Service will review the Employer's Annual Retirement Tax Return, Form CT-1, to determine what changes are required in the Form or Instructions.

10. Q. When sickness and accident benefits are paid by a third party to or for an employee of a State or local government, what are the third party's responsibilities under Pub. L. 97-123?

A. Pub. L. 97-123 made several changes in the FICA to facilitate the reporting of payments and the collection and deposit of FICA taxes when third party payments are made to private sector employees. When a third party makes a sickness and accident benefit payment to a private sector employee, the third party is treated as the employer for FICA tax purposes. However, the liability for the employer share of the FICA taxes shifts from the third party to the actual employer as soon as the third party has deposited the withheld employee FICA taxes and notified the actual employer of the amount of sick pay to be reported. Services performed in the employ of a State or political subdivision are specifically excluded from FICA coverage under section 3121 (b)(7) of the Code. The exclusion also applies to services performed in the employ of an instrumentality that is wholly owned by one or more states or one or more political subdivisions. Social Security coverage for these services can be obtained only by means of a voluntary agreement between the State and the Secretary of Health and Human Services under the provisions of Section 218 of the Social Security Act. Under these agreements States pay contributions in amounts equal to the combined employer/employee FICA taxes for all covered services. Approximately 75 percent of employees of State and local governments occupy positions included under a State agreement.

Pub. L. 97-123 did not amend Section 218 of the Social Security Act. Therefore, the third party payers are not obligated to withhold and deposit employee Social Security contributions on sick pay to employees of State or local governments. The third party is not treated as the employer, and the Social Security Administration will continue to hold the State liable for all wage reports and contribution returns in these sick pay situations. The third parties are encouraged, however, to contact the employing entities and to cooperate with them in making whatever arrangements are necessary to ensure both correct and timely deposits of Social Security contributions under the State agreement and accurate wage reports. Under no circumstances should the third party deposit the employee contributions under the FICA provisions.

---

26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 82-21

SECTION 1. BACKGROUND

Rev. Proc. 81-10, 1981-1 C.B. 647, sets forth areas in which advance rulings or determination letters will not be issued by the Internal Revenue

Service. Section 5 of Rev. Proc. 81-10 is entitled, Areas Under Extensive Study in which Rulings or Determination Letters Will Not Be Issued Until the Service Resolves the Issue Through Publication of a Revenue Ruling, Revenue Procedure, Regulations or Otherwise.

SEC. 2. PROCEDURE

Rev. Proc. 81-10 is hereby modified by deleting section 5.03 which reads "Section 1001.—Determination of Amount of and Recognition of Gain or Loss.—Determination of amount of, and recognition of, gain or loss in divorce property settlements."

SEC. 3. EFFECTIVE DATE

This revenue procedure will apply to all ruling requests on hand in the National Office on March 22, 1982, the date of publication of this revenue procedure in the Internal Revenue Bulletin, as well as to requests received thereafter.

SEC. 4. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 81-10 is modified.

---

26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 82-22

SECTION 1. PURPOSE AND NATURE OF CHANGES

.01 The purpose of this revenue procedure is to update Rev. Proc. 81-10, 1981-1 C.B. 647, as amplified by subsequent revenue procedures, by providing a revised list of those areas of the Internal Revenue Code under the jurisdiction of the Associate Chief Counsel (Technical) in which the Internal Revenue Service will not issue advance rulings or determination letters.

.02 Changes

1 New section 3.015 refers to section 119, See Rev. Proc. 82-8, page 413, this Bulletin.

2 New section 3.018 refers to section 170. See Rev. Proc. 82-11, page 429, this Bulletin.

3 New section 3.0123 refers to section 368(a)(1)(B). See Rev. Proc. 81-70, 1981-2 C.B. 729.

4 New section 3.0134 refers to section 2055. See Rev. Proc. 82-11.

5 New section 3.0136 refers to section 2522. See Rev. Proc. 82-11.

6 New section 5.01 refers to section 61. See Rev. Proc. 81-64, 1981-2 C.B. 690.

7 Old section 5.03 has been deleted. See Rev. Proc. 82-21, page 468, this Bulletin.

8 New section 5.03 refers to section 168(f)(8). See Rev. Proc. 81-72, 1981-2 C.B. 732.

9 New section 5.04 refers to section 304. See Rev. Proc. 81-61, 1981-2 C.B. 683.

10 New section 5.05 refers to section 368. See Rev. Proc. 81-67, 1981-2 C.B. 723.

11 New section 5.06 refers to section 422A. See Rev. Proc. 82-18, page 463, this Bulletin.

12 New section 5.07 refers to section 671. See Rev. Proc. 81-37, 1981-2 C.B. 592.

13 New section 5.09 refers to section 1372. Old section 5.04 revised to delete reference to aircraft rental business. See Rev. Proc. 81-32, 1981-2 C.B. 564.

14 New section 5.10 refers to section 2503. See Rev. Proc. 81-37.

15 New section 5.12 refers to section 7701. See Rev. Proc. 81-50, 1981-2 C.B. 624.

SEC. 2. BACKGROUND AND SCOPE OF APPLICATION

.01 Background

Whenever appropriate in the interest of sound tax administration, it is the policy of the Service to answer inquiries of individuals and organizations regarding their status for tax purposes and the tax effects of their acts or transactions, prior to the filing of returns or reports that are required by the revenue laws.

There are, however, certain areas in which, because of the inherently factual nature of the problems involved, or for other reasons, the Service will not issue advance rulings or determination letters. These areas are set forth in four sections of this revenue procedure. Section 3 reflects those areas in which advance rulings and determinations will not be issued. Section 4 sets forth those areas in which they will not ordinarily be issued. "Not ordinarily" connotes that unique and compelling reasons must be demonstrated to justify a ruling or determination letter. Those sections reflect a number of specific questions and problems as well as general areas. Section 5 lists specific areas for which the Service is temporarily not issuing advance rulings and determinations because those matters are under extensive study. Section 6 lists areas for which the Service is prohibited by statute from issuing rulings or determination letters.

With respect to the items listed, revenue rulings or revenue procedures may be published in the Internal Revenue Bulletin from time to time to provide general guidelines regarding the position of the Service.

Additions or deletions to this revenue procedure as well as restatement of items listed will be made by modification of this revenue procedure. Changes will be published as they occur throughout the year and will be incorporated annually in a new revenue procedure published in the first quarter of the next calendar year. These lists should not be considered all inclusive. Decisions not to rule on individual cases, as contrasted with those that present significant pattern issues, are not reported in this revenue procedure and will not be added to subsequent revisions.

The authority and general procedures of the Technical Function of the National Office of the Internal Revenue Service or the Offices of the District Directors of the Internal Revenue with respect to the issuance of advance rulings and determination letters with respect to Code sections under the jurisdiction of the Associate Chief Counsel (Technical) are outlined in Rev. Proc. 80-20, 1980-1 C.B. 633.

.02 Scope of Application.

This revenue procedure is not to be considered as precluding the submission of requests for technical advice to the National Office from the Office of a District Director of Internal Revenue or a Chief, Appeals Office.

SEC. 3. AREAS IN WHICH RULINGS OR DETERMINATION LETTERS WILL NOT BE ISSUED

.01 Specific questions and problems.

1 Section 79.—Group Term Life Insurance Purchased for Employees.—Whether a group insurance plan for 10 or more employees qualifies as group term insurance if the amount of insurance is not computed under a formula that would meet the requirements of section 1.79-1(c)(2)(ii) if the group consisted of fewer than 10 employees.

2 Section 83.—Property Transferred in Connection with Performance of Services.—Whether a restriction constitutes a substantial risk of forfeiture if the employee is a controlling shareholder. Also, whether a transfer has occurred if the amount paid for a purported transfer of property involves a nonrecourse obligation.

3 Section 105(h).—Amount Paid to Highly Compensated Individuals under a Discriminatory Self-Insured Medical Expense Reimbursement Plan.—Whether, following a determination that a self-insured medical expense reimbursement plan is discriminatory, that plan had previously made reasonable efforts to comply with tax discrimination rules.

4 Section 117.—Scholarships and Fellowship Grants.—Whether an employer-related scholarship or fellowship grant is excludable from the employee's gross income if there is no intermediary private foundation distributing the grants, as there was in Rev. Proc. 76-47, 1976-2 C.B. 670.

5 Section 119.—Meals or Lodging Furnished for the Convenience of the Employer.—Whether the value of meals or lodging is excludable from gross income by an employee who is a controlling shareholder of the employer.

6 Sections 121 and 1034.—One-Time Exclusion of Gain from Sale of Principal Residence by Individual Who Has Attained Age 55; Rollover of Gain on Sale of Principal Residence.—Whether at the time of its sale property qualifies as the taxpayer's principal residence.

7 Section 162.—Trade or Business Expenses.—Whether compensation is reasonable in amount.

8 Section 170.—Charitable, Etc., Contributions and Gifts.—Whether a charitable lead interest qualifies as a guaranteed annuity interest for purposes of section 170(f)(2)(B) of the Code if that interest may be prepaid before the expiration of the specified term of that interest or before the death of the life or lives used to measure the term of such interest.

9 Section 170.—Charitable, Etc., Contributions and Gifts.—Whether a taxpayer who advances funds to a charitable organization and receives therefor a promissory note may deduct as contributions, in one taxable year or in each of several years, amounts forgiven by the taxpayer in each of several years by endorsements on the note.

10 Section 264(b).—Certain Amounts Paid in Connection with Insurance Contracts.—Whether "substantially all" the premiums of a contract of insurance are paid within a period of 4 years from the date on which the contract is purchased. Also, whether an amount deposited is in payment of a "substantial number" of future premiums on such a contract.

11 Section 264(c)(1).—Certain Amounts Paid in Connection with Insurance Contracts.—Whether section 264(c)(1) of the Code applies.

12 Section 269.—Acquisitions Made to Evade or Avoid Income Tax.—Whether an acquisition is within the meaning of section 269 of the Code.

13 Section 302.—Distributions in Redemption of Stock.—Whether section 302(b) of the Code applies when the consideration given in redemption by a corporation consists entirely or partly of its notes payable, and the shareholder's stock is held in escrow or as security for payment of the notes with the possibility that the stock may or will be returned to the shareholder in the future, upon the happening of specified defaults by the corporation.

14 Section 302.—Distributions in Redemption of Stock.—Whether section 302(b) of the Code applies when the consideration given in redemption by a corporation in exchange for a shareholder's stock consists entirely or partly of the corporation's promise to pay an amount that is based on, or contingent on, future earnings of the corporation, or when the promise to pay is contingent on working capital being maintained at a certain level, or any other similar contingency.

15 Section 302.—Distributions in Redemption of Stock.—Whether section 302(b) of the Code applies to a redemption of stock if after the redemption the distributing corporation used property that is owned by the shareholder from whom the stock is redeemed and the payments by the corporation for the use of the property are dependent upon the corporation's future earnings or are subordinate to the claims of the corporation's general creditors. Payments for the use of property will not be considered to be dependent upon future earnings merely because they are based on a fixed percentage of receipts or sales.

16 Section 302.—Distributions in Redemption of Stock.—Whether the acquisition or disposition of stock described in section 302(c)(2)(B) of the Code has, or did not have, as one of its principal purposes the avoidance of federal income taxes within the meaning of that section, unless the facts and circumstances are materially identical to those set forth in Rev. Rul. 56-556, 1956-2, C.B. 177, Rev. Rul. 56-584, 1956-2 C.B. 179, Rev. Rul. 57-387, 1957-2 C.B. 225, Rev. Rul. 77-293, 1977-2 C.B. 91, or Rev. Rul. 79-67, 1979-1 C.B. 128.

17 Sections 311 and 336.—Taxability of Corporation on Distribution; General Rule.—Upon distribution of property in kind by a corporation to its shareholders, in complete liquidation under section 331 of the Code (when under the facts a sale of the property by the corporation would not qualify under section 337), in partial liquidation under section 346, or in redemption of stock under section 302(a), followed by a sale of the property, whether the sale can be deemed to have been made by the corporation under the doctrine of *Commissioner v. Court Holding Company*, 324 U.S. 331 (1945), Ct. D. 1636, 1945 C.B. 58.

18 Section 312.—Effect on Earnings and Profits.—The determination of the amount of earnings and profits of a corporation.

19 Sections 331, 332, and 333.—Effects on Recipients of Distributions in Corporate Liquidations.—The tax effect of the liquidation of a corporation preceded or followed by the reincorporation of all or a part of the business and assets when more than a nominal amount of the stock (that is, more

than 20 percent in value) of both the liquidating corporation and the transferee corporation is owned by the same shareholders; or when a liquidation is followed by the sale of the corporate assets by the shareholders to another corporation in which such shareholders own more than a nominal amount of the stock (that is, more than 20 percent in value).

20 Section 337.—Gain or Loss; Certain Liquidations.—The application of this section to a corporation upon the sale of property, in connection with its liquidation, to another corporation, when more than a nominal amount of the stock (that is, more than 20 percent in value) of both the selling corporation and the purchasing corporation is owned by the same persons.

21 Section 346.—Partial Liquidation.—The amount of working capital attributable to a business or portion of a business terminated that may be distributed in partial liquidation.

22 Section 351.—Transfers to Controlled Corporation.—

(a) That this section applies to a transfer by a shareholder of stock in one corporation (acquired) to another corporation (acquiring), in an exchange otherwise qualifying for treatment under this section, if the exchange is part of a larger transaction that fits a pattern common to acquisitive reorganizations, and after the transaction the acquiring corporation has control of the acquired corporation (within the meaning of section 368(c)), unless there is a continuing interest through stock ownership in the acquiring corporation on the part of the former shareholders of the acquired corporation that is equal in value to at least 50 percent of the value of all of the stock of the acquired corporation outstanding immediately before the overall transaction. For purposes of this determination, liabilities assumed or liabilities to which the property transferred is subject, will be considered to be part of the total consideration received. *See* Rev. Rul. 80-284, 1980-2 C.B. 117, and section 3.02 of Rev. Proc. 77-37, 1977-2 C.B. 568, 569.

(b) That this section applies to a transfer by a corporation (acquired) of a substantial portion of its assets to another corporation (acquiring), in an exchange otherwise qualifying for treatment under this section, if the exchange is part of a larger transaction that fits a pattern common to acquisitive reorganization, unless there is a continuing interest through stock ownership in the acquiring corporation on the part of the acquired corporation or shareholders of the acquired corporation that is equal in value to at least 50 percent of the value of all of the stock of the acquired corporation outstanding immediately before the overall transaction. For purposes of this determination, liabilities assumed or liabilities to which the property transferred is subject, will be considered to be part of the total consideration received. In addition, for purposes of this revenue procedure, an acquired corporation shall be deemed to have transferred a substantial portion of its assets if the transferred assets constitute 15 percent or more of its gross assets. See Rev. Rul. 80-285, 1980-2 C.B. 119, and section 3.02 of Rev. Proc. 77-37.

23 Section 368(a)(1)(B).—Definitions relating to Corporate Reorganizations.—The acceptability of an estimation procedure or the acceptability of a specific sampling procedure to determine the basis of stock acquired by an acquiring corporation in a reorganization described in section 368(a)(1)(B).

24 Section 451.—General Rule for Taxable Year of Inclusion.—The tax consequences of a nonqualified unfunded deferred compensation arrangement with respect to a controlling shareholder employee eligible to participate in the arrangement.

25 Sections 451 and 457.—General Rule for Taxable Year of Inclusion; Deferred Compensation Plans With Respect to Service for State and Local Governments.—The tax consequences to unidentified independent contractors in nonqualified unfunded deferred compensation plans. This applies to plans established under section 451 of the Code by employers in the private sector and to eligible state plans under section 457. However, a ruling with respect to a specific independent contractor's participation in such a plan may be issued.

26 Section 453.—Revolving Credit Sales as Installment Sales.—Whether a proposed sampling procedure will be acceptable by the Service for the purpose of determining the portion of revolving credit balances to be treated as installment account balances. See Rev. Proc. 64-4, 1964-1 (Part 1) C.B. 644, and Rev. Proc. 65-5, 1965-1 C.B. 720.

27 Section 642(c).—Deduction for Amounts Paid or Permanently Set Aside for a Charitable Purpose.—Allowance of an unlimited deduction for amounts set aside by a trust or estate for charitable purposes when there is a possibility that the corpus of the trust or estate may be invaded.

28 Section 704(b)(2).—Partner's Distributive Share Determined.—Whether the allocation to a partner under the partnership agreement of income, gain, loss, deduction, or credit (or an item thereof) has substantial economic effect.

29 Section 704(e).—Family Partnerships.—Matters relating to the validity of a family partnership when capital is not a material income producing factor.

30 Section 856.—Definition of a Real Estate Investment Trust.—Whether a corporation whose stock is "paired" with or "stapled" to that of another corporation will qualify as a real estate investment trust under section 856 of the Code if the activities of the corporations are integrated.

31 Section 1221.—Capital Asset Defined.—Whether specialty stock allocated to an investment account by a registered specialist on a national securities exchange is a capital asset.

32 Section 1551.—Disallowance of Surtax Exemption and Accumulated Earnings Credit.—Whether a transfer is within section 1551 of the Code.

33 Section 2031.—Definition of Gross Estate.—Actuarial factors for valuing interests in the prospective gross estate of a living person.

34 Section 2055.—Transfers for Public, Charitable and Religious Uses.—Whether a charitable lead interest qualifies as a guaranteed annuity interest for purposes of section 2055(e)(2)(B) of the Code if that interest may be prepaid before the expiration of the specified term of that interest or before the death of the life or

lives used to measure the term of such interest.

35 Section 2512.—Valuation of Gifts.—Actuarial factors for valuing prospective or hypothetical gifts of a donor.

36 Section 2522.—Charitable and Similar Gifts.—Whether a charitable lead interest qualifies as a guaranteed annuity interest for purposes of section 2522(c)(2)(B) of the Code if that interest may be prepaid before the expiration of the specified term of that interest or before the death of the life or lives used to measure the term of such interest.

37 Section 7701.—Definitions.—Whether a foreign arrangement that is a participant in a domestic arrangement classified as a partnership for U.S. tax purposes will itself be classified as a partnership.

38 Section 7701.—Definitions.—Whether a foreign limited liability company will be classified as a partnership if the taxpayer requests classification as a partnership and (1) the taxpayer is a corporation and less than 20 percent of the interests in the limited liability company are held by independent parties or (2) the taxpayer is not a corporation and independent parties hold only a nominal interest in the company.

39 Section 7701.—Definitions.—The classification of arrangements formed as partnerships under local law where the members of such partnerships are professional corporations.

.02 General Areas.

1 The results of transactions that lack bona fide business purpose or have as their principal purpose the reduction of federal taxes.

2 A matter upon which a court decision adverse to the government has been handed down and the question of following the decision or litigating further has not yet been resolved.

3 A matter involving the prospective application of the estate tax to the property or the estate of a living person.

4 A matter involving alternate plans of proposed transactions or involving hypothetical situations.

5 A matter involving the federal tax consequences of any proposed federal, state, local, or municipal legislation. The Service may provide general information in response to an inquiry.

6 Whether reasonable cause exists under Subtitle F (Procedure and Administration) of the Code.

7 Whether a proposed transaction would subject the taxpayer to a criminal penalty.

8 A request that does not comply with the provisions of Rev. Proc. 80-20.

SEC. 4. AREAS IN WHICH RULINGS OR DETERMINATION LETTERS WILL NOT ORDINARILY BE ISSUED

.01 Specific questions and problems.

1 Sections 61 and 163.—Gross Income Defined; Interest.—Determinations as to who is the true owner of property or the true borrower of money in cases in which the formal ownership of the property or liability for the indebtedness is in another party.

2 Section 167.—Depreciation

(a) Useful lives of assets.

(b) Depreciation rates.

(c) Salvage value of assets.

3 Section 170(c).—Charitable, etc., Contributions and Gifts.—Whether a taxpayer who transfers property to a charitable organization and thereafter leases back all or a portion of the transferred property, may deduct the fair market value of the property transferred and leased back as a charitable contribution.

4 Section 302.—Distribution in Redemption of Stock.—The tax effect of the redemption of stock for notes, when the payments on the notes are to be made over a period in excess of 15 years from the date of issuance of such notes.

5 Sections 304 and 357.—Redemption Through Use of Related Corporation; Assumption of Liability.—A transaction similar to that described in Rev. Rul. 80-240, 1980-2 C.B. 116, holding that sections 304(a)(1) and 357(a) of the Code are inapplicable because there was no assumption of liability, unless the taxpayer can satisfy the Internal Revenue Service that the liability was incurred by the taxpayer as a mere intermediary agent for the newly created corporate transferee. To establish this, the taxpayer must submit to the Internal Revenue Service documented evidence, composed at the time the liability was incurred, which indicates that the unrelated lender had agreed to release the transferor-borrower from any and all obligation on the liability in favor of the corporate transferee. Further, the taxpayer must show, or represent to, the Internal Revenue Service that the transfer and assumption actually occurred, or will actually occur within 12 months of the date the debt was incurred.

6 Section 306.—Disposition of Certain Stock.—Whether the distribution or disposition or redemption of "section 306 stock" in a closely held corporation is in pursuance of a plan having as one of its principal purposes the avoidance of federal income taxes within the meaning of section 306(b)(4) of the Code.

7 Section 331.—Gain or Loss to Shareholders in Corporate Liquidations.—The tax effect of the liquidation of a corporation by a series of distributions, when the distributions in liquidation are to be made over a period in excess of 3 years from the adoption of the plan of liquidation.

8 Section 341.—Collapsible Corporations.—Whether a corporation will be considered to be a "collapsible corporation," that is, whether it was "formed or availed of" with the view of certain tax consequences. However, ruling requests will be considered on this matter when the enterprise (1) has been in existence for at least 20 years, (2) has had substantially the same owners during that period, and (3) has conducted substantially the same trade or business during that period.

9 Section 351.—Transfers to Controlled Corporation.—The tax effect of the transfer when part of the consideration received by the transferors consists of bonds, debentures, or any other evidence of indebtedness of the transferee and the term of the "indebtedness" is either less than 10 years or a determination as to whether the "indebtedness" is properly classified as debt or equity is required in order to establish that the requirements of section 351 are met.

10 Section 871.—Tax on Nonresident Alien Individuals.—The determination as to whether an alien indi-

vidual is either a resident or nonresident of the United States will not be made with respect to situations in which the determination is dependent on factual representations that cannot be confirmed until the close of the alien individual's affected taxable year(s), that is, representations concerning an alien individual's projected stay and activities in the United States.

11 Section 992.—Requirements of a Domestic International Sales Corporation.—The tax effects of a Domestic International Sales Corporation's stock being held by individuals who are also shareholders in a related supplier corporation.

12 Section 7701.—Definitions.—Whether what is generally known as a foreign corporation will be classified as a partnership for U.S. tax purposes if the taxpayer requests classification as a partnership.

13 Section 7701.—Definitions.—Whether a foreign partnership will be classified as an association for U.S. tax purposes if the taxpayer requests classification as an association.

.02 General areas.

1 Any matter in which the determination requested is primarily one of fact, e.g., market value of property, or whether an interest in a corporation is to be treated as stock or indebtedness.

2 The tax effect of any transaction to be consummated at some indefinite future time.

3 Any matter dealing with the question of whether property is held primarily for sale to customers in the ordinary course of trade or business.

SEC. 5. AREAS UNDER EXTENSIVE STUDY IN WHICH RULINGS OR DETERMINATION LETTERS WILL NOT BE ISSUED UNTIL THE SERVICE RESOLVES THE ISSUE THROUGH PUBLICATION OF A REVENUE RULING, REVENUE PROCEDURE, REGULATIONS OR OTHERWISE

.01 Section 61.—Gross Income Defined.—Whether amounts voluntarily deferred by a taxpayer under a deferred compensation plan maintained by an organization described in section 501 of the Code are currently includible in the taxpayer's gross income.

.02 Section 79.—Group Term Life Insurance Purchased for Employees.—Whether life insurance provided for employees under a "retired lives reserve" plan will be considered group term insurance (also sections 61, 72, 83, 101, 162, 264, and 641).

.03 Section 168(f)(8).—Special Rule for Leases.—The tax consequences in certain areas specifically reserved in the Temporary Income Tax Regulations under the Economic Recovery Act of 1981, relating to special rules for leases. The areas specifically reserved are:

section 5c.168(f)(8)-8(b)(9) on retirements and casualties; section 5c.168(f)(8)-9 on the transfer of investment tax credit by section 168(f)(8) leases; section 5c.168(f)(8)-10 on leases between related parties; and section 5c.168(f)(8)-11 on consolidated returns.

.04 Section 304.—Redemption Through Use of Related Corporations.—Whether section 304, 351(a), or 351(b) of the Code applies to the transferors' receipt of property from an existing or newly formed transferee corporation in a transaction described in both sections 304 and 351. Property, for this purpose, is defined in section 317(a) and, in general, includes securities and short-term debt instruments of the transferee, and the assumption of liabilities, but excludes stock of the transferee.

.05 Section 368.—Definitions Relating to Corporate Reorganizations.—The tax consequences of a transaction intended to qualify as a reorganization under section 368(a)(1)(E) of the Code when the plan of reorganization provides for the use of contingent or escrow stock arrangements, and where the share adjustment is triggered by an event the occurrence or non-occurrence of which is within the control of the shareholders or is triggered by a Service audit of the shareholders or the corporation.

.06 Section 422A.—Incentive Stock Options.—Whether Holding (1) of Rev. Rul. 80-244, 1980-2 C.B. 234, relating to section 1036, applies to incentive stock options.

.07 Section 671.—Trust Income, Deductions, and Credits Attributable to Grantor and Others as Substantial Owners.—Whether the grantor will be considered the owner of any portion of a trust when (1) the trust corpus consists or will consist substantially of insurance policies on the life of the grantor or the grantor's spouse, (2) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (3) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, and (4) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under sections 673 to 677.

.08 Section 820.—Optional Treatment of Policies Reinsured Under Modified Coinsurance Contracts.—The tax consequences of modified coinsurance contracts to which section 820 of the Code may apply, including whether taxpayers who have entered into a modified coinsurance contract may allocate between the reinsured and reinsurer certain items to which section 820(c) applies.

.09 Section 1372.—Election by Small Business Corporation.—Whether trailer or mobile home parks qualify as electing small business corporations.

.10 Section 2503.—Taxable Gifts.—Whether the transfer of property to a trust will be a gift of a present interest in property when (1) the trust corpus consists or will consist substantially of insurance policies on the life of the grantor or the grantor's spouse, (2) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (3) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, (4) the trust beneficiaries have the power to withdraw, on demand, any additional transfers made to the trust, and (5) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under section 673 to 677.

.11 Section 7701.—Definitions.—Whether a trust which is beneficially owned by the shareholders of the settlor corporation is a trust for federal income tax purposes if the corporation remains in existence after the transfer in trust, and if the corporation retains working interests in oil, gas, or mineral properties, the royalty interests of which properties are transferred to the trust.

.12 Section 7701.—Definitions.—The classification of arrangements formed as trusts under local law, in which the trust borrows money to purchase equipment or property and leases it to third parties, and in which the grantor or grantors have a beneficial interest in the trust and the power to manage the activities of the trust.

SEC. 6. AREAS FOR WHICH THE SERVICE IS PROHIBITED BY STATUTE FROM ISSUING RULINGS OR DETERMINATION LETTERS

.01 Section 61.—Gross Income Defined.—Employee fringe benefits. Pub. L. 96-167, 1980-1 C.B. 483.

.02 Section 162.—Trade or Business Expenses.—Expenses of commuting, Pub. L. 96-167.

.03 Section 170.—Charitable, etc., Contributions and Gifts.—Application of revenue ruling (Rev. Rul. 79-99, 1979-1 C.B. 108) to deny a charitable contribution deduction. Pub. L. 96-74, 1979-2 C.B. 473.

SEC. 7. EFFECT ON OTHER DOCUMENTS

Rev. Procs. 81-10, 81-32, 81-37, 81-50, 81-61, 81-64, 81-67, 81-72, 82-8, 82-11, 82-18, and 82-21 are superseded.

---

26 CFR 601.201: Rulings and determination letters.
(Also Section 368; 1.368-1.)

Rev. Proc. 82-23 [1]

Rev. Proc. 77-37, 1977-2 C.B. 568, contains rules for the issuance of advance rulings as to matters within the jurisdiction of the Reorganization Branch of the Internal Revenue Service. Rev. Proc. 77-37 is amplified to include the following:

Solely for purposes of a reorganization otherwise qualifying under sections 368(a)(1)(G) and 368(a)(3)(D)(ii) of the Code the "continuity of business enterprise" requirement of section 1.368-1(d)(4) of the regulations is satisfied if (1) the acquiring corporation assumes all of the deposits of the acquired corporation and (2) the acquiring corporation will continue to hold at least one-half of the fair market value of the assets, including mortgage and other loans, held by the acquired corporation at the time of the adoption of the plan of reorganization. The disposition of assets by the acquiring corporation in the ordinary course of business will not be taken into account for this purpose.

EFFECT ON OTHER DOCUMENTS

Rev. Proc. 77-37 is amplified.

---

26 CFR 601.602: Tax forms and instructions.
(Also Part I, Section 6651; 301.6651-1.)

Rev. Proc. 82-24

SECTION 1. PURPOSE

The purpose of this revenue procedure is to advise Department of Defense contractors and subcontractors of the repeal of the requirement to file certain reports (Form 949, United States Annual Report of Profit on Military Contracts for Naval Vessels, and Form 949-A, United States Annual Report of Profit on Military Contracts for Aircraft) required by the Vinson-Trammel Act, 48 Stat. 503 (10 U.S.C. sections 2382 and 7300 (1970)).

SEC. 2. BACKGROUND

The Vinson-Trammel Act established profit limitations on certain prime contracts for the construction or manufacture of military aircraft and naval vessels and subcontracts thereunder. The requirements of the Vinson-Trammel Act became effective on September 30, 1976, when the Renegotiation Act of 1943 and successor Renegotiation Acts (current version at 50 U.S.C. sections 1211-1233 (1970)) expired.

One of the requirements of the Vinson-Trammel Act is that contractors and subcontractors must file certain reports (Forms 949 and 949-A) under sections 2382 and 7300, title 10 U.S.C. (1970). The Internal Revenue Service extended the time in which to file these reports to April 15, 1982, for taxpayers with tax years ending before August 1, 1981. *See* Section 4.02 of Rev. Proc. 77-47, 1977-2 C.B. 580, as modified by Rev. Proc. 78-20, 1978-2 C.B. 498, Rev. Proc. 78-38, 1978-2 C.B. 542, Rev. Proc. 79-25, 1979-1 C.B. 566, Rev. Proc. 79-53, 1979-2 C.B. 538, Rev. Proc. 80-13, 1980-1 C.B. 617, Rev. Proc. 80-45, 1980-2 C.B. 778, and Rev. Proc. 81-49, 1981-2 C.B. 624.

SEC. 3. PROCEDURE

In section 911(c) of the Department of Defense Authorization Act, 1982, Pub.L. 97-86, 97th Cong., 1st Sess. (December 1, 1981), Congress provided that no regulations could be issued or action taken for the purpose of enforcing any provision of section 2382 or section 7300 of title 10, U.S.C., with respect to any contract entered into during the period beginning on October 1, 1976, and ending on the date of the enactment of the Act. Further, in Section 911(a) and (b) of that same Act, Congress repealed section 7300 and amended section 2382 to provide that regulations to control excessive profits on defense contracts could only be issued by the President and then only in the event of a declaration of war by Congress or a declaration of national emergency by the President or by Congress.

The effect of section 911 of the Department of Defense Authorization Act, 1982, is to remove the obligation on contractors, subject to the Vinson-Trammel Act, to prepare and file Forms 949 and 949-A for all past years. Further, because section 911(a) provides that only the President may issue regulations in this area and then only in certain limited circumstances, there is no requirement at this time on contractors to file reports concerning excessive profits on defense contracts.

SEC. 4. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 77-47, 1977-2 C.B. 580, and Rev. Proc. 81-49, 1981-2 C.B. 624, are obsoleted.

SEC. 5. INQUIRIES

Inquiries in regard to this revenue

---

[1] Also released as News Release IR-82-36, dated March 10, 1982.

procedure should refer to its number and be addressed to the Commissioner of Internal Revenue, Attention T:C:C, 1111 Constitution Avenue, N.W., Washington D.C. 20224.

---

26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part I, Section 442; 1.442-1.)

Rev. Proc. 82-25

SECTION 1. PURPOSE

The purpose of this revenue procedure is to provide a procedure whereby individual taxpayers filing federal income tax returns on a fiscal year basis may expeditiously obtain approval to change their annual accounting period to a calendar year basis. A fiscal year taxpayer may obtain the full benefit of the individual income tax rate reductions of the Economic Recovery Tax Act of 1981 (ERTA) 1981-2 C.B. 256, by changing to a calendar year. Individual taxpayers complying with this revenue procedure will be deemed to have obtained the approval of the Commissioner of Internal Revenue for a change in accounting period.

SEC. 2. BACKGROUND

Section 442 of the Internal Revenue Code and section 1.442-1 of the Income Tax Regulations provide that in order to change an annual accounting period for federal income tax purposes, the taxpayer must obtain the approval of the Commissioner. Section 1.442-1(b)(1) requires that in order to obtain the approval, an application, Form 1128, Application for Change in Accounting Period, must be filed on or before the 15th day of the second calendar month following the close of the short period. Approval will not be granted unless the taxpayer and the Commissioner agree to the terms, conditions and adjustments under which the change will be effected. In general, a change of annual accounting period will be approved where the taxpayer establishes a substantial business purpose for making the change.

.02 Section 101(a) of the ERTA provides a series of reductions in individual income tax rates to take effect for taxable years beginning in 1982, 1983, and 1984.

.03 Under Section 21(a) of the Code, if a taxpayer's taxable year includes the effective date of a tax rate change (January 1 in the case of the changes made by ERTA), the tax for the year is tentatively determined under both the old and new rates. The actual tax for the year is a pro rata portion of the tax determined under the old rate plus a pro rata portion of the tax determined under the new rates. However, section 101(d)(3) of ERTA amends section 21(d) to provide that this proration rule does not apply to the individual tax rate reductions made by ERTA. Thus, individual fiscal year taxpayers will not benefit from these rate reductions during the period from January 1 to the end of their fiscal year.

.04 Section 5c.442-1 of the Temporary Income Tax Regulations provides special rules for a change of annual accounting period by taxpayers requesting a change from a fiscal year accounting period to a calendar year. These rules are applicable solely to a change in annual accounting period under the temporary regulations.

.05 The rules under section 5c.442-1 will apply if:

(1) The taxpayer requesting the change of annual accounting period is an individual;

(2) The requested change of annual accounting period is from a fiscal year to a calendar year;

(3) The purpose of the change is to benefit from the income tax rate reductions enacted by ERTA;

(4) In the case of a principal partner in a partnership formed after April 1, 1954, whose principal partners all change to a calendar year, the partnership changes to a calendar year;

(5) In the case of a shareholder in an electing small business corporation whose shareholders all change to a calendar year, the small business corporation changes to a calendar year; and

(6) The short period involved in the change ends on December 31, 1981 or December 31, 1982.

SEC. 3. APPLICATION

.01 In accordance with section 1.442-1(b) of the regulations and subject to the conditions contained in section 5c.442-1 of the temporary regulations and this revenue procedure, approval is hereby granted to an individual to change the individual's annual accounting period from a fiscal year basis to a calendar year.

.02 Solely for the purpose of section 5c.442-1 of the temporary regulations, the substantial business purpose requirement contained in section 1.442-1(b) of the regulations will not be applied.

.03 If the short period ending December 31, 1981 or December 31, 1982, produces a net operating loss, the net operating loss for the short period will be treated in accordance with the rules described below.

(1) If the net operating loss resulting from a short period of 9 months or longer is less than the net operating loss for a full 12 month period beginning with the first day of the short period, the net operating loss can be carried back or carried over in accordance with section 172(b) of the Code.

(2) If the net operating loss resulting from a short period of 9 months or longer equals or exceeds the net operating loss for a full 12 month period beginning with the first day of the short period and the net operating loss could otherwise be carried back under section 172(b) of the Code, the net operating loss is to be deducted ratably over a 10-year period commencing with the first taxable year after the short period. If the net operating loss from the short period could not otherwise be carried back under section 172(b), then the net operating loss can be carried over in accordance with section 172(b).

(3) If the net operating loss resulting from a short period of less than 9 months is greater than $10,000 and the loss could otherwise be carried back under section 172(b) of the Code, the net operating loss is to be deducted ratably over a 10-year period commencing with the first taxable year after the short period. If the net operating loss for the short period could not otherwise be carried back under section 172(b), then the net operating loss can be carried over in accordance with section 172(b).

(4) If the net operating loss resulting from a short period of less than 9 months is less than $10,000, the net operating loss can be carried back or carried over in accordance with section 172(b) of the Code.

.04 No subsequent change of annual accounting period will be approved if the short period involved in the subsequent change would end fewer than 5 calendar years after the last day of the short period involved in the change of accounting period described in section 5c.442-1 of the temporary regulations. If the short period involved in the subsequent change would end more than 5 calendar years after the last day of the short period involved in the change of accounting period, the Commissioner will determine whether to approve such change, (i) without regard to the change of annual accounting period described in section 5c.442-1; and (ii) in the case of a change to the fiscal year used by the taxpayer before the change of annual accounting period described in section 5c.442-1, without regard to the number of years that have elapsed since the taxpayer previously adopted such fiscal year.

SEC. 4. RECORDS

The books of the individual (records reflecting income adequately and clearly on the basis of an annual accounting period) must be closed as of the last day of the short period establishing a new taxable year. Federal income tax returns for subsequent taxable years must be made on the basis of a full 12 months ending on December 31 of the new taxable year.

SEC. 5. COMPLIANCE WITH CONDITIONS

.01 In accordance with section 1.442-1(b)(1) of the regulations, approval for a change in accounting period will not be granted unless the taxpayer and the Commissioner agree to the terms, conditions, and adjustments under which the change will be effected. In connection with a change in accounting period from a fiscal year to a calendar year in accordance with section 5c.442-1 of the temporary regulations, all such terms, conditions, and adjustments are as set forth herein.

.02 Individual taxpayers requesting a change in accounting period from a fiscal year to a calendar year in accordance with section 5c.442-1 of the temporary regulations without complying with all the conditions of this revenue procedure or section 5c.442-1 of the temporary regulations, will be deemed to have initiated the change in accounting period without obtaining the consent of the Commissioner.

SEC. 6. MANNER OF EFFECTING THE CHANGE

.01 Individual taxpayers requesting a change in accounting period from a fiscal year to a calendar year in accordance with section 5c.442-1 of the temporary regulations and this revenue procedure must effect the change by filing a current Form 1128 with the federal income tax return for the short period ending December 31, 1981 or December 31, 1982. For the short period ending December 31, 1981, the Form 1128 and the federal income tax return must be filed no later than June 15, 1982. Thus, individual taxpayers complying with section 5c.442-1 of the temporary regulations and this revenue procedure will be granted an automatic extension until June 15, 1982, to file Form 1128 and their individual income tax return. No penalty for late payment will be asserted if the balance of the tax is paid by June 15, 1982; however, interest at the rate of 20 percent a year will be charged on any unpaid tax after April 15, 1982. Individuals who wish to avoid payment of interest on the total tax due should file Form 4868, Application for Extension of Time to File U.S. Individual Income Tax Return, by April 15, 1982, and pay the tax estimated to be due on the return when filed. For the short period ending December 31, 1982, the Form 1128 and the federal income tax return must be filed no later then April 15, 1983.

.02 In order to assist in the processing of the change in accounting period and to insure proper handling, reference to this revenue procedure shall be made a part of the federal income tax return and the Form 1128 by either typing or legibly printing the following statement at the top of page 1 of the federal income tax return and Form 1128: "FILED UNDER REV. PROC. 82-25."

.03 If an individual taxpayer with a fiscal year ending after December 31, 1981, files a federal income tax return prior to June 15, 1982, and wishes to utilize the change in accounting period provisions of section 5c.442-1 of the temporary regulations and this revenue procedure, the previously filed federal income tax return may be amended and the federal income tax return for the short period ending December 31, 1981 and the Form 1128 must be filed no later than June 15, 1982. No penalty for late payments will be asserted if the balance of the tax is paid by June 15, 1982; however, interest at the rate of 20 percent a year will be charged on any unpaid tax after April 15, 1982. Individuals who wish to avoid payment of interest on the total tax due should file Form 4868 by April 15, 1982, and pay the tax estimated to be due on the return when filed.

.04 The taxpayer shall disclose on the Form 1128 any partnership formed after April 1, 1954, in which the taxpayer is a principal partner or any electing small business corporation in which the taxpayer is a shareholder.

.05 Where it is found that the taxpayer does not qualify for the automatic change in accounting period under section 5c.442-1 of the temporary regulations and this revenue procedure, the Service Center or the district director will advise the taxpayer.

SEC. 7. EFFECTIVE DATE

This revenue procedure shall be effective for changes in annual accounting period from a fiscal year to a calendar year where the short period ends December 31, 1981 or December 31, 1982.

SEC. 8. INQUIRIES

Inquiries in regard to this revenue procedure should refer to its number and be addressed to the Commissioner of Internal Revenue, Attention CC:C:C:1, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

---

26 CFR 601.201: Rulings and determination letters.
(Also Part I, Section 103; 1.103-1.)

Rev. Proc. 82-26

SECTION 1. PURPOSE

The purpose of this revenue procedure is to set forth the circumstances under which the Service will ordinarily issue an advance ruling that obligations issued by a corporation organized under the general nonprofit corporation law of a state ("nonprofit corporation" or "corporation") will be considered obligations of a state or a political subdivision of a state under section 103(a)(1) of the Internal Revenue Code.

SEC. 2. BACKGROUND

Section 103 of the Code provides that, subject to the exceptions set forth in sections 103(b), 103(c), 103(f) and 103A, interest on the obligations of a state, a territory, or a possession of the United States, or any of their political subdivisions, or of the District of Columbia ("governmental units") are not includible in gross income. Section 1.103-1(b) of the Income Tax Regulations provides that obligations issued on behalf of any governmental unit by constituted authorities empowered to issue such obligations are the obligations of the unit.

The Service has issued three revenue rulings that hold that obligations issued by a nonprofit corporation will be considered obligations of a governmental unit under section 1.103-1(b) of the regulations if certain conditions are met.

Rev. Rul. 54-296, 1954-2 C.B. 59, holds that notes issued by a nonprofit corporation organized by a group of public-spirited citizens to make improvements to a city-owned building are considered obligations of the city if (1) the city owns all of the stock in the corporation, (2) the city will become absolute owner of the improvements upon retirement of the notes by the corporation at or prior to maturity or upon assumption or discharge of the notes by the city, whichever occurs first, and (3) all of the income earned from the rental of the building inures to the city.

Rev. Rul. 59-41, 1959-1 C.B. 13, holds that obligations issued by a nonprofit corporation organized at the request of a city to finance the acquisition of a system for the supply and distribution of water in and near the city are the obligations of the city if (1) none of the net earnings or assets of the corporation inures to any private person, (2) the city has the right to purchase the system at any time for the outstanding indebtedness of the corporation plus interest, (3) the city will receive, without demand or further action, fee ownership and immediate exclusive possession of the system when the corporation's debt is paid, (4) the city has stated its intention to take title at that time, and (5) the city has approved the issuance of the obligations and has the right to make recommendations to the corporation regarding operation of the system.

Rev. Rul. 63-20, 1963-1 C.B. 24, holds that obligations of a nonprofit corporation will be considered issued on behalf of a governmental unit if (1) the corporation engages in activities that are essentially public in nature, (2) the corporation is not organized for profit, except to the extent of retiring indebtedness, (3) the corporate income does not inure to any private person, (4) the governmental unit has a beneficial interest in the corporation while the indebtedness is outstanding, and it obtains full legal title to the property of the corporation with respect to which the indebtedness was incurred upon retirement of the indebtedness, and (5) the corporation and the specific obligations to be issued by the corporation have been approved by the governmental unit on whose behalf the obligations are issued.

The requirements enumerated in Rev. Rul. 63-20 apply to obligations issued by the nonprofit corporations described in Rev. Ruls. 54-296 and 59-41. Under this revenue procedure, the Service will ordinarily issue an advance ruling that obligations issued by a nonprofit corporation meet the requirements in Rev. Rul. 63-20, if the operating rules of sections 3 and 4 below are met.

Historically, the Service has required that certain conditions be met before it issued an advance ruling that obligations issued by a nonprofit corporation met the requirements of Rev. Rul. 63-20. This revenue procedure is intended only to state in one document the conditions that the Service has required to be met in prior years before such an advance ruling was issued. This revenue procedure is not intended to change or add to the conditions that the Service required to be met before it would issue such an advance ruling.

This revenue procedure is not intended to address the question of whether an entity is a political subdivision of a state within the meaning of section 103 of the Code. Further, this revenue procedure is not intended to address the issue of whether obligations issued by a corporation that is organized either under a special state statute or a statute providing that only governmental units may organize the corporation meet the requirements of Rev. Rul. 57-187, 1957-1 C.B. 65, or Rev. Rul. 60-248, 1960-2 C.B. 35. In addition, this revenue procedure is not intended to address the issue of whether trusts created under state laws to further certain public functions meet the requirements of Rev. Rul. 57-151, 1957-1 C.B. 64. Moreover, this revenue procedure does not apply to issues of qualified scholarship funding bonds defined in section 103(e), which are exempt from federal income tax under section 103(a)(2).

The operating rules of this revenue procedure are intended only to assist issuers of governmental obligations, and other parties with a material financial interest, in preparing ruling requests. The operating rules do not define, as a matter of law, the circumstances under which obligations to be issued by a nonprofit corporation will be considered issued on behalf of a governmental unit within the meaning of section 1.103-1(b) of the regulations. Thus, the operating rules are not to be used as tests for determining the taxability of bond interest.

The authority and general procedures of the National Office and the Offices of the District Directors of Internal Revenue for issuing advance rulings and determination letters are outlined in Rev. Proc. 80-20, 1980-1 C.B. 633, as modified, clarified, and amplified by Rev. Proc. 81-33, 1981-32 I.R.B. 19, and in section 601.201 of the Statement of Procedural Rules (26 CFR section 601.201 (1980)). Also see Rev. Proc. 79-4, 1979-1 C.B. 483; Rev. Proc. 79-12, 1979-1 C.B. 492, as amplified by Rev. Proc. 80-1, 1980-1 C.B. 579; and Rev. Proc. 82-22, page 469, this Bulletin. Careful attention to all of the requirements of these documents will help prevent delays in processing requests for rulings.

SEC. 3. GENERAL OPERATING RULES

The Service will ordinarily rule that obligations issued by a nonprofit corporation are issued on behalf of a governmental unit within the meaning of section 1.103-1(b) of the regulations if the following requirements are met:

.01 The nonprofit corporation must engage in activities that are essentially public in nature. This requirement will be met if:

1 The activities and purposes of the corporation are those permitted under the general nonprofit corporation law of the state; and

2 The property to be provided by the corporation's obligations is located within the geographical boundaries of or has a substantial connection with the governmental unit on whose behalf the obligations are issued.

.02 The corporation must not be organized for profit except to the extent of retiring indebtedness. This requirement will be met if:

1 The corporation is organized under the general nonprofit corporation law of the state in which is located the governmental unit on whose behalf the corporation will issue its obligations; and

2 The articles of incorporation of the corporation provide that the corporation is one that is not organized for profit.

.03 The corporate income may not inure to any private person. This requirement will be met if the articles of incorporation provide that the corporate income will not inure to any private person, and in fact, the corporate income does not inure to any private person.

.04 The governmental unit must have a beneficial interest in the corporation while the indebtedness remains outstanding. This requirement will be met if:

1(a) The governmental unit has exclusive beneficial possession and use of a portion of the property financed by the obligations and additions to that property equivalent to 95 percent or more of its fair rental value for the life of the obligations (including any other obligations, such as those described in section 3.055 of this revenue procedure, issued by the nonprofit corporation either to make improvements to the property or to refund a prior issue of the corporation's obligations). For purposes of determining whether an obligation is an industrial development bond under section 103(b) of the Code, a nonprofit corporation in the circumstances described in this subparagraph will be considered an exempt person within the meaning of section 103(b)(3) even if the corporation is not an organization described in section 501(c)(3) that is exempt from federal taxation under section 501(a). Use by an instrumentality of a governmental unit will be considered use by the unit if the instrumentality is an instrumentality of only the governmental unit on whose behalf the obligations are issued and the requirements of Rev. Rul. 57-128, 1957-1 C.B. 311, are otherwise met; or

(b)(1) The nonprofit corporation has exclusive beneficial possession and use of a portion of the property financed by the obligations, and any additions to that property, equivalent to 95 percent or more of its fair rental value for the life of the obligations; and

(2) The governmental unit on whose behalf the nonprofit corporation is issuing the obligations (A) appoints or approves the appointment of at least 80 percent of the members of the governing board of the corporation, and (B) has the power to remove, for cause, either directly or through judicial proceedings, any member of the governing board and appoint a successor. If the articles of incorporation of the nonprofit corporation provide that ex-officio representatives of the governmental unit constitute all or a part of the membership of the governing board of the corporation, then the requirements of (A) and (B) shall not apply to the ex-officio members; or

(c) The government unit has the right at any time to obtain unencumbered fee title and exclusive possession of the property financed by the obligations, and any additions to that property, by (1) placing into escrow an amount that will be sufficient to defease the obligations, and (2) paying reasonable costs incident to the defeasance. However, the governmental unit, at any time before it defeases the obligations, may not agree or otherwise be obligated to convey any interest in the property to any person (including the United States of America or its agencies or instrumentalities) for any period extending beyond or beginning after the unit defeases the obligations. In addition, generally the unit may not agree or otherwise be obligated to convey a fee interest in the property to any person who was a user of the property, or a related person under section 103(b)(6)(C) of the Code, before the defeasance within 90 days after the unit defeases the obligations. If the governmental unit exercises its right under this subparagraph, the corporation must immediately cancel all encumbrances on the property, including leases and management contracts. Any lease, management contract, or other similar encumbrance on the property will be considered immediately cancelled if the lessee, management company, or other user vacates the property within a reasonable time, generally not to exceed 90 days, after the date the governmental unit exercises its right under this subparagraph. Encumbrances that do not significantly interfere with the enjoyment of the property, such as most easements granted to utility companies, are not considered encumbrances for purposes of this subparagraph; and

2 In the event the nonprofit corporation defaults in its payments under the obligations, the governmental unit has an exclusive option to purchase the property financed by the obligations and additions to that property for the amount of the outstanding indebtedness and accrued interest to the date of default. The governmental unit shall have (a) not less than 90 days from the date it is notified by the nonprofit corporation of the default in which to exercise the option, and (b) not less than 90 days from the date it exercises the option to purchase the property. This requirement does not apply if the governmental unit has the use of the property described in paragraph 1(a) above.

.05 The governmental unit must obtain full legal title to the property of the corporation with respect to which the indebtedness was incurred upon retirement of the indebtedness. This requirement will be met if:

1 The obligations of the nonprofit

corporation are issued on behalf of no more than one governmental unit and unencumbered fee title to the property will vest solely in that governmental unit when the obligations are discharged. For purposes of this revenue procedure obligations are discharged when (a) cash is available at the place of payment on the date that the obligations are due (whether at maturity or upon prior call for redemption) and (b) interest ceases to accrue on the obligations; and

2 All of the original proceeds and investment proceeds of the obligations are used to provide tangible real or tangible personal property. Proceeds are considered to provide tangible property only if the proceeds are (a) used to finance costs that a taxpayer must charge to the property's capital account, may elect to charge to the property's capital account instead of deducting, or may elect to deduct instead of charging to the property's capital account, and (b) used to fund a reasonably required reserve fund within the meaning of section 103(c)(4) of the Code. The previous sentence does not apply to a *de minimis* amount, less than $5,000, that is included in the bond issue solely for the purpose of rounding the dollar amount of the issue. If excess proceeds remain on hand after the acquisition or completion of construction or reconstruction of the property, the requirements of this subsection will be considered met if (a) the face amount of the obligations (taking into account estimated investment proceeds) was based on reasonable estimates of the cost of the property at the time the obligations were issued, and (b) the excess proceeds are used and invested in the manner described in sections 3.04, 3.05, and 3.06 of Rev. Proc. 79-5, 1979-1 C.B. 485, as amplified by Rev. Proc. 81-22, 1981-1 C.B. 692.

Amounts used to provide a borrower with working capital are not used to provide tangible property. For example, if the proceeds of obligations issued by a nonprofit corporation are used to acquire property from a charitable organization and the corporation subsequently leases the property back to the charitable organization, the proceeds are not used to provide tangible property. Similarly, if the proceeds of obligations issued by a nonprofit corporation are used to acquire a portfolio of outstanding mortgages on tangible property, the proceeds are not used to provide tangible property.

For purposes of this revenue procedure, original proceeds are amounts (after payment of all expenses of issuing the obligations) received at any time as a result of the sale of an issue of obligations. For purposes of this revenue procedure investment proceeds are amounts (net of administrative costs) that result from the investment of any proceeds of an issue of obligations. However, for purposes of this subsection investment proceeds do not include amounts earned after the date that (1) the construction, reconstruction, or acquisition of the property is completed, or (2) all of the proceeds (less amounts used to fund a reasonably required reserve fund) have been spent on the construction, reconstruction, or acquisition of the property, whichever occurs later (for rules concerning refunding issues see section 4.01 of this revenue procedure); and

3 The governmental unit obtains upon discharge of the obligations unencumbered fee title and exclusive possession and use of the property financed by the obligations, including any additions to the property, without demand or further action on its part. Thus, for example, all leases, management contracts, and other similar encumbrances must terminate upon discharge of the obligations. Encumbrances that do not significantly interfere with the enjoyment of the property, such as most easements granted to utility companies, are not considered encumbrances for purposes of this paragraph. If a nonprofit corporation sells interim short-term obligations on behalf of a governmental unit in anticipation of selling permanent financing to provide tangible property, the requirements of this paragraph will be met if (a) the government unit obtains unencumbered fee title and exclusive possession and use of the property upon discharge of the permanent financing and (b) the last issue of interim short-term obligations used to provide the property is discharged not later than five years after the date of issue of the first issue of short-term obligations; and

4 Before the obligations are issued, the governmental unit adopts a resolution stating that it will accept title to the property financed by the obligations, including any additions to that property, when the obligations are discharged; and

5 The indenture or other documents under which the obligations used to originally provide the property provide that any other obligations issued by the nonprofit corporation either to make improvements to the property or to refund a prior issue of the nonprofit corporation's obligations will be discharged no later than the latest maturity date of the original obligations, regardless of whether the original obligations are callable at an earlier date. In addition, the maturity date of the original obligations or any other obligations issued by the nonprofit corporation with respect to the property may not be extended beyond the latest maturity date of the original obligations, regardless of whether the original obligations are callable at an earlier date. If the governmental unit has the beneficial interest described in section 3.041(a) of this revenue procedure, the obligations need not meet the requirements of this paragraph (for additional rules concerning refunding issues, see section 4.01 of this revenue procedure); and

6 The proceeds of fire or other casualty insurance policies received in connection with damage to or destruction of the property financed by the obligations, including any additions to the property, will, subject to the claims of the holders of the obligations, (a) be used to reconstruct the property, regardless of whether the insurance proceeds are sufficient to pay for the reconstruction, or (b) be remitted to the governmental unit; and

7(a) A reasonable estimate of the fair market value of the property on the latest maturity date of the obligations, regardless of whether the obligations are callable at an earlier date, is equal to at least 20 percent of the original cost of the property financed by the obligations. The estimated fair market value of property shall be determined without including in the value any addition to the property or any increase or decrease for inflation or deflation during the term of the obligations; and

(b) A reasonable estimate of the remaining useful life of the property on the latest maturity date of the obligations, regardless of whether the obligations are callable at an earlier date, is the longer of one year or 20 percent of the originally estimated useful life of the property financed by the obligations.

If the property financed by the obligations does not itself meet the requirements of (a) and (b) of this paragraph, these requirements will be considered met if the nonprofit corporation is required to replace the property and the replacement property meets the requirements of (a) and (b) of this paragraph. If the governmental unit has the beneficial interest described in section 3.041(a) of this revenue procedure, the obligations need not meet the requirements of this paragraph.

.06 The governmental unit must approve both the nonprofit corporation and the specific obligations to be issued by the corporation. This requirement will be met if, within one year prior to the issuance of the obligations, the governmental unit adopts a resolution approving the purposes and activities of the corporation and the specific obligations to be issued by the corporation. If the corporation intends to issue obligations for a single project through a series of obligations to be issued over a period not to exceed five years, the governmental unit may meet the requirements of this subsection by adopting a single resolution, approving the purposes and activities of the corporation and all obligations to be issued in the series, within one year prior to the issuance of the first issue in the series.

SEC. 4. OPERATING RULES FOR REFUNDING ISSUES

.01 The Service will ordinarily issue an advance ruling that refunding obligations issued by a nonprofit corporation are issued on behalf of a governmental unit if:

1 All of the original and investment proceeds of the refunding issue are used (a) to pay principal, qualified interest, and any premium, on another issue ("the prior issue") of obligations issued on behalf of the governmental unit, and (b) to fund a reasonably required reserve fund for the refunding issue within the meaning of section 103(c)(4) of the Code. For purposes of this subsection, investment proceeds do not include amounts earned after the last obligation of the prior issue is discharged. Qualified interest means unpaid interest on the prior issue reduced by the amount of original proceeds and investment proceeds of the prior issue allocated to pay interest on the prior issue but unexpended therefor. However, unpaid interest on a prior issue shall not be treated as qualified interest if interest on the prior issue is payable less frequently than is reasonable and customary for issues of its type; and

2 The obligations are not advance refunding obligations. For purposes of this subsection advance refunding obligations are refunding obligations that are issued more than 180 days before the date on which the prior obligations are discharged. However, the Service will ordinarily issue an advance ruling that advance refunding obligations issued by a nonprofit corporation are issued on behalf of a governmental unit if the obligations used to provide the tangible property meet the beneficial interest requirement of section 3.04 of this revenue procedure because the governmental unit has the interest described in section 3.041(a); and

3 The refunding obligations will be discharged no later than the latest maturity date of the obligations that were issued by the nonprofit corporation to originally provide the property, regardless of whether the original obligations are callable at an earlier date. If the governmental unit has the beneficial interest described in section 3.041(a) of this revenue procedure, the obligations need not meet the requirements of this paragraph.

4 The requirements set forth in section 3 of this revenue procedure are met, except that section 4.011 instead of section 3.052 shall apply to refunding issues.

SEC. 5. INQUIRIES

Inquiries about this revenue procedure should refer to its number and should be addressed to the Associate Chief Counsel (Technical), Attention: CC:IND:I, Internal Revenue Service, 1111 Constitution Ave., N.W., Washington, D.C. 20224.

---

26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 82-27

SECTION 1. BACKGROUND

Rev. Proc. 82-22, page 469, this Bulletin, provides a list of those areas of the Internal Revenue Code under the jurisdiction of the Associate Chief Counsel (Technical) which are under extensive study and in which ruling or determination letters will not be issued until the Service resolves the issue through publication of a revenue ruling, revenue procedure, regulations, or otherwise. A list of those areas is set forth in section 5 of the Rev. Proc.

SEC. 2. PROCEDURE

Rev. Proc. 82-22 is amplified to include the following under section 5:

Section 306.—Dispositions of Certain Stock.—Whether preferred stock received by an exchanging shareholder who either actually owns some common stock or actually owns no common stock after the exchange is "section 306 stock" in those cases where utilization of the principles of section 318 of the Code in applying the "cash in lieu of" test of section 1.306-3(d) of the Income Tax Regulations would result in such shareholder's receipt of a dividend pursuant to section 302(d).

SEC. 3. EFFECTIVE DATE

This revenue procedure will apply to all ruling requests on hand in the National Office on April 19, 1982 the date of publication of this revenue procedure in the Internal Revenue Bulletin, as well as to requests received thereafter.

SEC. 4. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 82-22 is amplified.

---

26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 82-28

SECTION 1. BACKGROUND

Rev. Proc. 82-22, page 469, this

Bulletin, sets forth areas in which advance rulings or determination letters will not be issued by the Internal Revenue Service. Section 5 of Rev. Proc. 82-22 is entitled, Areas Under Extensive Study in Which Rulings or Determination Letters Will Not Be Issued Until the Service Resolves the Issue Through Publication of a Revenue Ruling, Revenue Procedure, Regulations or Otherwise.

SEC. 2. PROCEDURE

Rev. Proc. 82-22 is hereby amplified by adding to section 5:

Section 704(e)—Family Partnerships—Any matter relating to a family partnership in which, on formation of the partnership or other specified date, there is a special allocation of an item of income, gain, loss, deduction or credit for the purpose of fixing or freezing the value of a partner's partnership interest.

SEC. 3. EFFECTIVE DATE

This revenue procedure will apply to all ruling requests on hand in the National Office on April 26, 1982, the date of publication of this revenue procedure in the Internal Revenue Bulletin, as well as to requests received thereafter.

SEC. 4. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 82-22 is amplified.

---

26 CFR 601.201: Rulings and determination letters.
(Also Part I, Section 482; 1.482-1.)

Rev. Proc. 82-29

SECTION 1. PURPOSE AND SCOPE

This revenue procedure explains the procedures to be used by the Internal Revenue Service and taxpayers in certain cases of double taxation that are governed by income tax treaties of the United States. The cases covered by this revenue procedure concern the allocation of income and deductions between a United States taxpayer and a related person (including a branch office) subject to the taxing jurisdiction of a country ("treaty country") that has entered into an income tax treaty with the United States. See Rev. Proc. 77-16, 1977-1 C.B. 573, for competent authority procedures used in resolving issues other than allocation of income and deductions, including the availability to United States taxpayers of credits against foreign tax, exemptions from foreign tax, reduced rates of foreign tax, and other benefits and safeguards. Rev. Proc. 70-18, 1970-2 C.B. 493, as amplified by Rev. Proc. 79-31, 1979-1 C.B. 599, is modified and superseded by this revenue procedure.

SEC. 2. BACKGROUND

01. Income tax treaties in force between the United States and other countries generally provide for the allocation of income and deductions among related persons whose dealings with each other are not the same as those that would be made between independent persons. These treaties recognize that taxation by a treaty country of a taxpayer with an affiliate or branch office that is subject to the taxing jurisdiction of the other treaty country may result in actual or economic double taxation. As a result, these treaties provide for consultation by the competent authorities of the United States and of treaty countries on the allocation of income and deductions between related persons. The provisions of this revenue procedure do not override the provisions of any income tax treaty entered into by the United States. Taxpayers should make themselves aware of the full content of the income tax treaty under which they are operating.

02. When the United States competent authority and a treaty country competent authority agree to discuss an allocation, whether made or proposed by the United States or by the treaty country, the United States competent authority will attempt to reach an agreement that is acceptable to the United States, to the treaty country, and to the related persons.

03. The Associate Commissioner (Operations) acts as the United States competent authority in administering the operating provisions of tax treaties and in interpreting or applying these treaties. In interpreting or applying tax treaties, the Associate Commissioner (Operations) acts only with the concurrence of the Associate Chief Counsel (Technical).

04. If the United States taxpayer fails to request competent authority consideration under this revenue procedure, the taxpayer may be denied a credit for foreign tax. See Rev. Rul. 76-508, 1976-2 C.B. 225, as amplified by Rev. Rul. 80-231, 1980-2 C.B. 219, and section 4.901-2(f)(5) of the Temporary Income Tax Regulations, T.D. 7739, 1981-1 C.B. 396.

05. The Associate Commissioner (Operations) may negotiate an agreement with the competent authority of a treaty country concerning the allocation of income or deductions between a United States taxpayer and a related person at the request of the United States taxpayer. The Associate Commissioner (Operations) also may initiate competent authority negotiations in any situation to protect United States economic interests. Such a situation may arise when a taxpayer fails to request competent authority consideration after agreeing to an allocation of income or deductions that creates either actual or economic double taxation.

06. The taxpayer should send written requests for competent authority consideration to the Associate Commissioner (Operations), Internal Revenue Service, P.O. Box 7799, Washington, D.C. 20044.

SEC. 3. GENERAL CONDITIONS UNDER WHICH THIS PROCEDURE APPLIES

01. The procedures prescribed in sections 3 through 9 of this revenue procedure apply when the United States or other treaty country allocates or proposes to allocate income or deductions and this allocation may result in actual or economic double taxation.

02. In seeking to arrive at an agreement with a treaty country, the United States competent authority will be guided by the standards of arm's length dealing (referred to in the regulations under section 482 of the Internal Revenue Code) and the equivalent standard of arrangements or conditions that would have been made between independent persons (referred to in a number or treaties). The United States competent authority also will take into account all of the facts

and circumstances and the purpose of the treaty to avoid double taxation when negotiating agreements on the allocation of income and deductions.

03. It is the position of the United States competent authority not to reopen a case previously closed after examination to make an adjustment unfavorable to the taxpayer unless the exceptional circumstances described in Rev. Proc. 74-5, 1974-1 C.B. 416, are present. The United States competent authority may accept a taxpayer's request for competent authority consideration that will require the reopening of a case closed after examination.

04. If there is no income tax treaty between the United States and another country there is no authority for the Service to provide relief from United States tax due to double taxation arising under the tax laws of the other country and the United States. Therefore, in such a case the United States competent authority is unable to consider a taxpayer's request that involves a nontreaty country.

SEC. 4. PROCEDURES TO BE FOLLOWED IF TREATY COUNTRY PROPOSES ALLOCATION

01. If a treaty country allocates or proposes to allocate the income or deductions attributable to transactions involving a United States taxpayer, the United States taxpayer should request United States competent authority consideration.

02. The taxpayer must file a written request for competent authority consideration with the Associate Commissioner (Operations), Internal Revenue Service, P.O. Box 7799, Washington, DC 20044, as soon as practical after the treaty country's position on the adjustment has been sufficiently developed to permit consideration, whether or not the adjustment has been formally proposed. In any event, the request should be filed no later than 90 days after the treaty country's adjustments are formally communicated to the related person.

03. At the time of the request for competent authority consideration, the United States taxpayer must file an amended United States tax return (for example, a Form 1120X Amended U.S. Corporation Income Tax Return if a Form 1120 was originally filed), as provided by the regulations under section 6402, with the Internal Revenue Service Center where the original return for the same tax year was filed. On the amended United States tax return the taxpayer may claim a credit or refund of the taxes attributable to the proposed allocation and shall indicate that a competent authority request is being filed. A copy of the amended United States tax return shall be attached to the request for competent authority consideration.

04. The competent authority request must be signed by a person having authority to sign the United States taxpayer's federal income tax returns. The request must contain a statement that competent authority consideration is being requested and must include the following information:

(a) a reference to the specific income tax treaty provisions under which the request is made;

(b) the names, addresses, and taxpayer identification numbers of the United States taxpayer and all related persons involved in the proposed allocation and the tax years affected;

(c) the office where the United States taxpayer and the related person or persons filed federal income tax returns for the years in question;

(d) a statement whether the federal income tax returns of both the United States taxpayer and the related person or persons for the years in question were examined, or are in the process of being examined;

(e) a description of the control and business relationships between the United States taxpayer and the related person or persons;

(f) a statement of the status of the tax liability of the related person in the treaty country for the year or years of the proposed adjustment;

(g) actions requested of, proposed, or taken by the competent authority of the treaty country, a description of the pertinent transactions and the issues, and the amount of any correlative adjustment that would have to be made to the income or deductions of the United States taxpayer if the United States competent authority were to accept the position of the treaty country;

(h) copies of pertinent foreign income tax returns (with English translation), and a schedule (in United States dollars) showing the allocation proposed by the treaty country and computation of the resulting foreign tax;

(i) copies of pertinent correspondence from the treaty country, briefs, protests, and other relevant material (all with English translation);

(j) copies of Foreign Tax Credit Computation (Forms 1118) that were filed with the tax return for each year under consideration;

(k) copies of powers of attorney on file with respect to the United States taxpayer; and

(l) on a separate document, a statement that the United States taxpayer consents to the disclosure to the competent authority of the treaty country (with the name of the country specifically stated) and the competent authority's staff of any or all of the items of information set forth or enclosed in the request for United States competent authority consideration. This statement must be dated and signed by a person having authority to sign the United States taxpayer's federal income tax return and is required to facilitate the administrative handling of the request by the United States competent authority for purposes of the recordkeeping requirements of section 6103(p) of the Code. Failure to provide such a statement will not prevent the United States competent authority from disclosing information under the terms of a tax treaty. See section 6103(k)(4).

05. If a treaty country is considering but has not yet proposed any adjustments to income or deductions arising out of transactions of or with a United States taxpayer, and the United States statutory period in which the United States taxpayer can file a claim for credit or refund of income taxes for the years involved is about to expire, the United States taxpayer should file a protective claim for credit or refund of these taxes on the appropriate amended United States tax return (including, to the extent available, the information required in a competent authority request under section 4.04 above). The amended United States tax return must be filed with the Internal Revenue Service Center where the original tax return for the same tax year was filed. The

taxpayer must send a copy of the amended United States tax return to the Associate Commissioner (Operations) (see section 2.06 above for address). Final disposition of the amended United States tax return will be deferred by the Service pending: (1) the perfection of the request for competent authority consideration under section 4.01 above and the disposition of the issues under consideration; or (2) the withdrawal of the claim for credit or refund by the taxpayer. Beginning 6 months after the amended United States tax return is filed and every 6 months thereafter, the taxpayer must state in writing (by a person authorized to sign its federal income tax returns) to the Associate Commissioner (Operations) that the treaty country is still considering an adjustment of the income or deductions. The statement must include any available information described in section 4.04 above not previously submitted and any necessary modifications or previously submitted information. The Associate Commissioner (Operations) may deny competent authority consideration if the United States taxpayer fails to file the supplemental statement within each 6 month period.

06. The amended United States tax return filed under this revenue procedure permits only the making of a credit or refund that is agreed to by the United States and the treaty country competent authorities or that is unilaterally allowed by the United States competent authority. This revenue procedure does not grant a United States taxpayer the right to invoke section 482 of the Code in its favor or compel the Service to allocate income or deductions or grant a tax credit or refund. If the United States taxpayer accepts the decision of the competent authority, the decision of the competent authority is not subject to judicial review.

SEC. 5. PROCEDURES TO BE FOLLOWED IF THE UNITED STATES PROPOSES ALLOCATION

01. If the Service allocates or proposes to allocate income or deductions attributable to transactions involving a United States taxpayer subject to the tax jurisdiction of a treaty country, the United States taxpayer should request United States competent authority consideration. (See Rev. Rul. 76-508, as amplified by Rev. Rul. 80-231. Also see section 6 of this revenue procedure for procedures to be followed by the related person if any.)

02. A written request for competent authority consideration should be submitted as soon as the amount of the adjustment is determined, communicated in writing to the taxpayer, and agreed to by the taxpayer subject to competent authority relief. Taxpayers who do not agree with the correctness of the adjustment are encouraged to pursue their right of administrative review before the Appeals Division before requesting competent authority relief.

03. The taxpayer must file the written request for competent authority consideration with the Service office where the United States taxpayer's case is pending. A copy of the request must be filed with the Associate Commissioner (Operations), Internal Revenue Service, P.O. Box 7799, Washington, DC 20044. However, if the request for competent authority is not filed until after a suit contesting the tax liability of the taxpayer is pending in a court in the United States, the request should be filed with the Chief Counsel, Attention: Associate Chief Counsel (Litigation), Internal Revenue Service, Washington, DC 20044, and a copy filed with the Associate Commissioner (Operations).

04. The Internal Revenue Service office receiving the written request for competent authority consideration will promptly forward a copy of the request, pertinent files, and other appropriate information and documents to the Associate Commissioner (Operations).

05. If a request for competent authority consideration is filed, the Service will postpone further examination action on the issues accepted for competent authority consideration, except for cases pending in court and other cases in which action must be taken to avoid prejudicing the Government's interest. If there are other issues raised during the examination and the taxpayer is not in agreement with these issues, the district director will follow the usual procedures and issue the taxpayer a thirty-day letter. In preparing a protest of the unagreed issues, the taxpayer need not include any unagreed issue under consideration by the competent authority. Following the receipt of the taxpayer's protest, appeal procedures shall be initiated with respect to those issues not subject to competent authority consideration. If the competent authorities are unable to resolve the double taxation problem to the satisfaction of the United States taxpayer and the taxpayer wishes to then pursue other administrative or judicial avenues of appeal, the original protest will then be amended to include the issue unresolved by the competent authority.

06. The United States competent authority will not accept any taxpayer's request for consideration of a case that is pending in court without Chief Counsel's consent. If the case is pending in the United States Tax Court, the Chief Counsel may in appropriate cases request the court to delay trial pending competent authority action. If the case is pending in any other court, the Chief Counsel will consult with the Department of Justice about appropriate action. Final decision on delaying trial rests with the court. However, the filing of a competent authority request does not relieve the taxpayer from taking any action that may become necessary with respect to litigation. On completion of the competent authority consideration, the taxpayer must reinstate litigation if the taxpayer decides to continue litigation.

07. The competent authority request must be signed by a person having authority to sign the United States taxpayer's federal tax returns. The request must contain a statement that competent authority consideration is being requested and must include the following information:

(a) a reference to the specific income tax treaty provisions under which the request is made;

(b) the names, addresses, and taxpayer identification numbers of the United States taxpayer and all related taxpayers involved in the proposed allocation and the tax year affected;

READEX FICHE

(c) the district office which has made or is proposing to make the adjustment;

(d) a description of the control and business relationships between the United States taxpayer and the related person or persons;

(e) a statement of the status of the tax liability of the related person in the treaty country for the year or years of the proposed adjustment;

(f) actions requested of, proposed, or taken by the competent authority of the treaty country, a description of the pertinent transactions and the issues and the amount of any correlative adjustment that would have to be made to the related person's income or deductions if the treaty country competent authority were to accept the position of the United States;

(g) the adjustments should be stated in United States dollars and the appropriate foreign currency, identifying the conversion method used to reconcile the United States entity's books and records with the foreign entity's books and records;

(h) copies of pertinent foreign income tax returns, correspondence, briefs, protests, and other relevant material (with English translation);

(i) copies of Foreign Tax Credit Computation (Forms 1118) that were filed with the tax return for each year under consideration;

(j) copies of powers of attorney on file with respect to the United States taxpayer;

(k) copies of pertinent Forms 2952 (Information Return with Respect to Controlled Foreign Corporations), including copies of the financial statements and surplus analysis required to be filed with the return for each related entity and for each year under consideration; and

(l) on a separate document, a statement that the United States taxpayer consents to the disclosure to the competent authority of the treaty country (with the name of the country specifically stated) and the competent authority's staff of any or all of the items of information set forth or enclosed in the request for competent authority consideration. This statement must be dated and signed by a person having authority to sign the United States taxpayer's federal income tax returns and is required to facilitate the administrative handling of the request by the United States competent authority for purposes of the recordkeeping requirements of section 6103(p) of the Code. Failure to provide such a statement will not prevent the United States competent authority from disclosing information under the terms of a tax treaty. See section 6103(k)(4).

SEC. 6. NOTIFICATION TO RELATED ENTITY

In any case covered by section 4 or 5 of this revenue procedure, the United States taxpayer should either itself take, or advise a related person to take, such timely protective action as may be necessary with foreign tax authorities. This includes the staying of the expiration of the foreign period of limitations on the making of a refund or other tax adjustment, complying with any applicable procedures of the treaty country for invoking competent authority consideration, and attempting to resist an adjustment or obtain an appropriate correlative adjustment.

SEC. 7. CASES RECEIVED FROM, AND REFERRED TO, FOREIGN COMPETENT AUTHORITIES

01. The United States competent authority will not initiate action under this revenue procedure with respect to foreign corporations, partnerships, or other entities of a treaty country. Requests sent to the United States competent authority by these taxpayers will be referred to the competent authority of the treaty country.

02. When a treaty country competent authority refers a request for mutual agreement to the United States competent authority, the United States competent authority will contact the United States taxpayer and advise the taxpayer to comply with this revenue procedure in order to obtain consideration by the United States competent authority.

SEC. 8. REV. PROC. 65-17

Rev. Proc. 65-17, 1965-1 C.B. 833, and Amendment I of Rev. Proc. 65-17, 1966-2 C.B. 1211, as amplified by Rev. Proc. 65-31, 1965-2 C.B. 1024, provide that the United States taxpayer must file a request for the treatment provided by Rev. Proc. 65-17 in writing with the appropriate district director before closing action is taken on the section 482 issue that forecloses availability of Rev. Proc. 65-17. Therefore, if a United States taxpayer desires competent authority action and the benefits provided by Rev. Proc. 65-17, the taxpayer must file a request under Rev. Proc. 65-17 before entering into any closing agreement or before any other closing action (as defined in section 4.03 of Rev. Proc. 65-31) is taken on the section 482 issue.

Rev. Rul. 82-80, page 7, this Bulletin, states that a United States subsidiary, whose taxable income has been increased for a tax year because of an allocation under section 482 of the Code, may receive payment from its foreign parent corporation from which, or to which, the allocation of income or deductions was made, in an amount not in excess of the taxable income increase without further federal income tax consequences. For procedures to be followed in applying this position and requirements that must be fulfilled to qualify for such treatment, see Rev. Proc. 65-17.

SEC. 9. ACTION BY COMPETENT AUTHORITY

01. The United States taxpayer will be notified if the facts provide a basis for competent authority assistance. The United States competent authority will not assist the taxpayer if:

(a) under the facts and circumstances the taxpayer is not entitled to such assistance (for example, actual or economic double taxation does not exist);

(b) the taxpayer indicates unwillingness to accept a competent authority agreement except under conditions that are clearly unreasonable or unfairly prejudicial to the interests of the United States;

(c) the taxpayer does not accept the concept that competent authority negotiations are a government to government activity that does not include the taxpayer's participation in the negotiation proceedings;

(d) the taxpayer does not furnish, upon request, sufficient information to determine whether the treaty applies to the taxpayer's facts and circumstances, or the taxpayer otherwise fails to act as required by this procedure;

(e) the request is from a taxpayer under the jurisdiction of another competent authority (see section 7.01 of this revenue procedure); or

(f) the taxpayer has demonstrated an unwillingness to execute a consent extending the period of limitations on assessment of tax for the tax year or years under consideration (see section 9.02 of this revenue procedure).

02. If the United States competent authority accepts a request for consideration, the United States taxpayer must supply any additional information needed to resolve the case and keep the United States competent authority informed about proceedings in the treaty country or any other pertinent developments. The taxpayer also may be requested to execute a consent extending the period of limitations on assessment of tax for the tax year or years concerned.

03. If the United States competent authority denies assistance, the United States taxpayer may ask the Commissioner of Internal Revenue to name a panel and have the panel review the denial of assistance. The panel will notify the taxpayer that the taxpayer may present oral arguments at a hearing, if so desired, in support of the taxpayer's request for competent authority assistance. The decision of the panel whether competent authority assistance should be provided is final and is not subject to judicial review. The United States competent authority will notify the taxpayer of the panel's decision. If the panel decides that the case is suitable for competent authority assistance, the United States competent authority will assist the taxpayer in accordance with this revenue procedure.

04. The United States competent authority will notify a taxpayer requesting assistance under this revenue procedure of any agreement or partial agreement that the United States and the treaty country competent authority reach with respect to the request. If such agreement or partial agreement is not acceptable to the taxpayer, the taxpayer may withdraw the request for competent authority consideration and may then pursue all rights to administrative and judicial review otherwise available under the laws of the treaty country and the United States.

05. When appropriate, in cases covered by sections 4 and 5 of this revenue procedure, the taxpayer will be requested to enter into a closing agreement reflecting the terms of the competent authority in accordance with sections 6.07 and 6.17 of Rev. Proc. 68-16, 1968-1 C.B. 770.

06. The United States competent authority will not grant unilateral relief to a United States taxpayer with respect to an adjustment to income, deductions, credits or other items solely because the period of limitations has expired in the foreign country and the competent authority of that country has declined to grant any relief from double taxation.

If the period provided by the foreign statute of limitations has expired, then the United States competent authority may take into account other relevant facts and may, as a matter of discretion, provide unilateral relief with respect to the adjustment to the extent necessary to avoid actual or economic double taxation of income. Relevant facts include the absence of actual or constructive notice of the proposed allocation so that the taxpayer could not avail itself of any remedies in the foreign jurisdiction; the absence of abusive tax arrangements in the structuring of the relevant international relationships and transactions; and the absence of recurring adjustments. In no event, however, will relief be granted where there is fraud or negligence with respect to the relevant international relationships and transactions.

Unilateral relief will generally only be granted by the United States in the context of a tax treaty used by the other competent authority to grant unilateral relief to taxpayers of that country. If an income tax treaty is not in force with a particular foreign country, then the service will not provide relief with respect to an adjustment because the period of limitations of that country has expired.

SEC. 10. REQUEST FOR RULINGS

01. Requests for advance rulings about the interpretation or application of a treaty on United States taxation, as distinguished from requests to the United States competent authority under this revenue procedure or Rev. Proc. 77-16, should be submitted to the Associate Chief Counsel (Technical) in accordance with Rev. Proc. 80-20, 1980-1 C.B. 633.

02. The Service does not issue advance rulings on the effect of the treaty on the tax laws of the treaty country for purposes of determining the tax of the treaty country or the meaning of a treaty article for that purpose.

SEC. 11. EFFECTIVE DATE

This revenue procedure is effective May 3, 1982.

SEC. 12. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 70-18 and Rev. Proc. 79-31 are superseded.

---

26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 82-30[1]

SECTION 1. BACKGROUND

Rev. Proc. 82-22, page 469, this Bulletin, contains in section 3 a list of those areas of the Internal Revenue Code under the jurisdiction of the Associate Chief Counsel (Technical) in which ruling or determination letters will not be issued. In order to facilitate more efficient utilization of personnel resources, a new subsection concerning section 368(a)(1)(E) of the Code is being added. There are no current plans to include other sections of the Code as a no ruling area for this stated purpose.

SEC. 2. PROCEDURE

Rev. Proc. 82-22 is amplified to include the following under section 3:

Section 368(a)(1)(E).—Definitions relating to Corporate Reorganizations.—Whether a transaction constitutes a corporate recapitalization within the meaning of section 368(a)(1)(E) of the Code (or a transaction that also qualifies under section 1036) except when the recapitalization is an integral part of a larger transaction and it is impossible to determine the tax consequences of the larger transaction without making a determination with regard to the recapitalization.

---

[1] Also released as News Release IR-82-48, dated April 28, 1982.

SEC. 3. EFFECTIVE DATE

This revenue procedure is effective with regard to all ruling requests postmarked after April 30, 1982.

SEC. 4. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 82-22 is amplified.

---

26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 82-31

SECTION 1. BACKGROUND

Rev. Proc. 82-22, page 469, this Bulletin, contains in section 5 a list of those areas of the Internal Revenue Code under the jurisdiction of the Associate Chief Counsel (Technical) which are under extensive study and in which ruling or determination letters will not be issued until the Service resolves the issue through publication of a revenue ruling, revenue procedure, regulations or otherwise.

SEC. 2. PROCEDURE

Rev. Proc. 82-22 is amplified to include the following under section 5:

"Section 346.—Partial Liquidation.—Whether the absence of an actual redemption of stock is a meaningless gesture within the meaning of Rev. Rul. 79-257, 1979-2 C.B. 136, as amplified by Rev. Rul. 81-3 1981-1 C.B. 125, when:

(i) the corporation has outstanding more than one class of stock and there are priorities in dividend or liquidating distributions or any other differences in stock rights, or

(ii) either under the terms of the stock or as established contractually, there are outstanding any rights affecting the corporation's stock, such as, but not limited to, warrants, options, convertible securities, shareholder agreements, or rights of first refusal."

SEC. 3. EFFECTS ON OTHER REVENUE PROCEDURES

Section 5 of Rev. Proc. 82-22 is amplified.

SEC. 4. EFFECTIVE DATE

This revenue procedure will apply to all ruling requests on hand in the National Office on May 10, 1982, the date of publication of this revenue procedure in the Internal Revenue Bulletin, as well as to requests received thereafter.

---

26 CFR 601.604: Changes in accounting periods and methods of accounting.
(Also Part I, Sections 162, 446, 481; 1.162-10, 1.446-1, 1.481-1.)

Rev. Proc. 82-32

SECTION 1. PURPOSE

The purpose of this revenue procedure is to provide a procedure whereby taxpayers that employ an accrual method as their overall method of accounting may expeditiously obtain consent to change their method of accounting for deducting vacation pay applicable to fully-vested plans. The change is from the method of deducting vested vacation pay in the tax year in which it is paid to the method of deducting vested vacation pay in the tax year in which it accrues. Taxpayers complying with the provisions of this revenue procedure will be deemed to have obtained the consent of the Commissioner of Internal Revenue to change to an accrual method for deducting vacation pay applicable to fully-vested vacation pay plans.

SEC. 2. BACKGROUND

01. Many taxpayers that employ an accrual method as their overall method of accounting deduct vacation pay applicable to their fully-vested vacation pay plans in the tax year in which it is paid. For purposes of this revenue procedure, a vacation pay plan is considered to be fully-vested if an employee has an absolute and unconditional right to receive either additional compensation or time off from work as of the end of the year in which vacation pay is accrued. Employees who must complete a probationary period under a fully-vested plan before receiving an absolute and unconditional right to receive vacation pay will not be considered to be covered as a fully vested employee until the probationary period requirements are met. Under a fully-vested plan, the liability to each specific employee for vacation pay is clearly established and the amount of the liability can be calculated with reasonable accuracy as of the end of the tax year in which the vacation pay accrues. Thus, in accordance with section 1.461-1(a)(2) of the Income Tax Regulations the vacation pay is properly deductible in the tax year it accrues.

02. Accrual method taxpayers who desire to change their method of accounting for deducting vacation pay applicable to their fully-vested vacation pay plans from the method of deducting such vacation pay in the year in which it is paid to the method of deducting the vacation pay in the year in which it accrues, must do so in accordance with section 446(e) of the Internal Revenue Code and the regulations thereunder.

03. Section 446(e) of the Code and section 1.446-1(e) of the regulations provide that in order to change a method of accounting for federal income tax purposes the taxpayer must obtain the consent of the Commissioner. Section 1.446-1(e)(3)(i) requires that in order to obtain such consent, an application must be filed within 180 days after the beginning of the tax year in which the taxpayer desires to make the change. Section 1.446-1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the limitations, terms, and conditions deemed necessary to permit a taxpayer to obtain consent to a change in its method of accounting in accordance with section 446(e).

04. Section 481(a) of the Code requires that those adjustments necessary to prevent amounts from being duplicated or omitted be taken into account when the taxpayer's taxable income is computed under a method of accounting different from the method used to compute taxable income for the preceding tax year. Section 481(c) and section 1.481-5 of the regulations provide that the adjustment required

by section 481(a) may be taken into account in determining taxable income in the manner and subject to the conditions agreed to by the Commissioner and the taxpayer.

SEC. 3. SCOPE

This revenue procedure applies to taxpayers who: (1) employ an accrual method as their overall method of accounting; (2) provide paid vacations for their employees in accordance with fully-vested vacation pay plans; (3) pay the amount accrued no later than the tax year succeeding the year of accrual; and (4) desire to change their method of accounting from deducting the vacation pay for the year in which it is paid to the method of deducting the vacation pay for the year in which it becomes fully vested and accrues.

SEC. 4. APPLICATION

01. In accordance with section 1.446-1(e)(3)(ii) of the regulations the 180 day rule is waived and under section 1.446-1(e)(2)(i) consent is hereby granted to taxpayers using an accrual method of accounting to change their method of accounting with respect to fully-vested vacation pay plans from the method of deducting the vacation pay in the tax year in which it is paid to the method of deducting the vacation pay in the tax year in which it becomes fully vested and accrues. This consent is granted for the tax year for which a taxpayer requests a change (year of change) by filing a current Form 3115, Application for Change in Accounting Method, in the manner described in section 6 of this revenue procedure, and by otherwise complying with the provisions of this revenue procedure. See section 5 of this revenue procedure regarding compliance with the conditions of this revenue procedure.

02. An adjustment is required to prevent deductions from being omitted when a change in method of accounting is made under the provisions set forth in this revenue procedure. The adjustment, which is negative in this case, referred to as the "section 481(a) adjustment," shall be taken into account in computing taxable income and in computing earnings and profits in the manner provided in section 4.03 below. See Rev. Proc. 79-47, 1979-2 C.B. 528, as to earnings and profits. The approved change shall be considered to be a change in method of accounting initiated by the taxpayer.

03. 1 The appropriate period for taking into account the section 481(a) adjustment referred to in section 4.02 (adjustment period) is generally to be determined as follows:

(a) When the entire amount of the section 481(a) adjustment is attributable to the tax year immediately preceding the year of change (first preceding year), the total adjustment is to be taken into account in computing taxable income for the year of change. The amount attributable to the tax year immediately preceding the year of change is the difference in the amount of the adjustment determined under section 481(a) of the Code for the year of change and the amount that would have been required under section 481(a) if the same change in method of accounting had been made in the preceding year.

(b) When (a) does not apply and 67 percent or more of the amount of the section 481(a) adjustment is attributable to the 1-tax year period, 2-tax year period, or 3-tax year period immediately preceding the year of change the highest percent attributable to the 1, 2, or 3-tax year period will be taken into account ratably over a 3-tax year period beginning with the year of change. Any remaining balance will be taken into account ratably over an additional period equal to the remainder of the number of tax years the taxpayer has used the method of accounting that is being changed. However, the total adjustment period shall not exceed 10 tax years. This subparagraph, 4.03 1(b), only applies if the taxpayer has used the method being changed for more than 3 tax years. If the method of accounting being changed has been used for no more than 4 tax years, 75 percent shall be substituted for 67 percent. An amount attributable to the 1, 2, or 3-tax year period is the difference in the amount of the adjustment determined under section 481(a) of the Code for the year of change and the amount that would have been required under section 481(a) if the same change had been made at the beginning of the preceding 1, 2, or 3-tax year period.

(c) In all other situations in which (a) and (b) above do not apply, the total section 481(a) adjustment will be taken into account ratably over the number of years (not to exceed 10) the taxpayer has used the accounting method that is being changed.

(d) If the taxpayer is engaged in a trade or business to which the provisions of section 1.471-11 of the regulations apply, it must treat vacation pay attributable to services performed incident to and necessary for production or manufacturing operations or processes as inventoriable costs. Thus, subparagraph (a), (b) or (c) of this section will not apply to any portion of the adjustment which is properly allocable to inventories under the full absorption method of inventory costing provided in section 1.471-11. The taxpayer must adjust its beginning inventory for the tax year of change for any amount of vacation pay properly allocable to the beginning inventory. However, the portion of the vacation pay not properly allocable to inventories under the full absorption method of inventory costing will be taken into account under either subparagraph (a), (b), or (c) of this section.

2 In applying sections 4.03 1(a) or (b), if a taxpayer's books and records do not contain sufficient information to compute the section 481(a) adjustment attributable to the 1, 2, or 3-tax year period immediately preceding the year of change, the taxpayer may reasonably estimate the amounts and attach and sign (or have signed by an officer who has personal knowledge of the facts) the following statement to the Form 3115:

Under penalty of perjury, I hereby certify that:

(a) the books and records of (name of the taxpayer) do not contain sufficient information to permit a computation of the section 481(a) adjustment attributable to the 1-tax year period, 2-tax year period, or 3-tax year period immediately preceding the year of change as required by section 4.03 1(b) of Rev.Proc. 82-32.

(b) Based on the information that is contained in the records, to the best of my information and belief, the entire amount of the section 481(a) adjustment for the year of change (indicate either "is" or "is not", as the case may be) attributable to the tax year immediately preceding the year of change, and 67 percent (or 75 percent in applicable cases) or more of the section 481(a) adjustment for the year of change (indicate "is" or "is not", as the case may be) attributable to the 1-tax year period, 2-tax year period, or 3-tax year period immediately preceding the year of change.

3 For an example of the application of the rules prescribed in section 4.03 1 with respect to the appropriate period for taking into account the section 481(a) adjustment see Example A in section 5.13 of Rev. Proc. 80-51, 1980-2 C.B. 818.

.04 This revenue procedure does not apply to taxpayers that employ the cash receipts and disbursements method as their overall method of accounting. This revenue procedure does not apply to taxpayers' vacation pay plans that are not fully-vested and therefore the liability for that vacation pay does not accrue under section 1.461-1(a)(2) of the regulations in a tax year other than when it is paid. This revenue procedure does not apply to amounts accrued under vested vacation pay plans where the payment may take place later than the tax year succeeding the year of accrual. In addition, this revenue procedure does not apply to a taxpayer who has deducted vacation pay applicable to fully-vested vacation pay plans in the tax year in which it is paid and the use of that method is pending as an issue in connection with the examination of the taxpayer's federal income tax return for any year prior to the year of change or is an issue before any federal court.

.05 Ceasing to engage in the trade or business.

(a) With respect to a corporation:

If the taxpayer ceases to engage in the trade or business, to which the section 481(a) adjustment (sections 4.02 and 4.03) relates, at any time prior to the expiration of the adjustment period referred to in section 4.03, the taxpayer shall take into account in that year the balance of the adjustment not previously taken into account in computing taxable income. See Rev. Rul. 80-39, 1980-1 C.B. 112, which holds that if a division of a corporation, for which a change in method of accounting had been granted, ceases to operate the trade or business for which the change in method was granted, the remaining section 481(a) adjustment applicable to the business conducted by that division of the corporation must be taken into income in the year the corporation ceases to engage in that trade or business. For purposes of this condition, the taxpayer is not considered to have ceased the trade or business if the cessation is the result of a transaction to which section 381 of the Code applies, but in that case the acquiring corporation shall continue to be subject to this revenue procedure as though it were the acquired corporation.

(b) With respect to a partnership:

In the event a partnership terminates or ceases to engage in the trade or business (within the meaning of section 708 of the Code), to which the section 481(a) adjustment (sections 4.02 and 4.03) relates, at any time prior to the expiration of the adjustment period referred to in section 4.03, the balance of the adjustment not previously taken into account in computing ordinary income shall be taken into account in the year of cessation. A partnership ceasing to engage in the trade or business includes the incorporation of such trade or business in a transaction to which section 351 applies. (See Rev. Rul. 77-264, 1977-2 C.B. 187).

(c) With respect to a sole proprietor:

If a sole proprietor ceases to engage in the trade or business, to which the section 481(a) adjustment (section 4.02 and 4.03) relates, at any time prior to the expiration of the adjustment period referred to in section 4.03, the balance of the adjustment not previously taken into account in computing taxable income shall be taken into account in the year of cessation. A sole proprietor ceasing to engage in the trade or business includes the incorporation of the trade or business in a transaction to which section 351 of the Code applies (see Rev. Rul. 77-264). A sole proprietorship does not cease to engage in that trade or business when the individual taxpayer sells a partial interest in the proprietorship and continues to be actively engaged in the management of the business that is subsequently operated as a partnership. The section 481(a) adjustment remaining at the time the partnership is formed is taken into account by the partnership as though there had been no change in ownership (see Rev. Rul. 66-206, 1966-2 C.B. 206).

.06 If the taxpayer does not keep its books and records in accordance with the method of accounting granted by section 4.01 of this revenue procedure, the taxpayer must reconcile its books and records at the end of the year of change and at the end of later tax years to reflect the new method of accounting for deducting vacation pay applicable to fully-vested vacation pay plans.

SEC. 5. COMPLIANCE WITH CONDITIONS

Taxpayers making a change for deducting vacation pay applicable to fully-vested plans without complying with all the conditions of this revenue procedure will be deemed to have initiated the change in method of accounting without obtaining the consent of the Commissioner.

SEC. 6. MANNER OF EFFECTING THE CHANGE

.01 Taxpayers to which this revenue procedure applies must effect the change in their methods of accounting pursuant to the provisions set forth in this revenue procedure by filing a current Form 3115 in duplicate. The original shall be attached to the taxpayer's timely filed federal income tax return. A copy of the Form 3115 shall be filed with the National Office addressed to the Commissioner of Internal Revenue, Attention: CC:C:C:1, 1111 Constitution Avenue, N.W., Washington, DC 20224, no later than 270 days after the beginning of the tax year of change. The Service will acknowledge the receipt of the copy of the Form 3115 by return mail. A copy of this acknowledgement is to be attached by the taxpayer to the original current Form 3115 that is attached to the taxpayer's federal income tax return for the year of change. In addition to including all of the information required on the current Form 3115, the taxpayer must state: (1) that it proposes to take the section 481(a) adjustment into account over the appropriate period required by section 4.03; and (2) the period over which the section 481(a) adjustment will be taken into account and the reason for such conclusion. If the taxpayer is a manufacturer it must state that any portion of the section 481(a) adjustment properly allocable to inventories under the full absorption method of inventory costing provided in section 1.471-11 of the regulations will not be treated under section 4.03 of this revenue procedure, but instead, will be added to the taxpayer's opening inventory for the year of change. The National Office will sample the Form 3115's to determine whether the requirements of this revenue procedure have been followed. The National Office or the district director may advise the taxpayer of required adjustments to the change in method of accounting for vacation pay filed under this revenue procedure. Also, where it is found that the taxpayer does not qualify for automatic change in method of accounting under this revenue procedure the National Office or the district director will so advise the taxpayer.

.02 In order to assist in the processing of these changes in methods of accounting and to insure proper handling, reference to this revenue procedure shall be made a part of the Form 3115 by either typing or legibly printing the following statement at the top of page 1 of Form 3115: "FILED UNDER REV. PROC. 82-32."

.03 The signature of the individual or person preparing the application for the taxpayer must appear in the space at the bottom of page 1 on the Form 3115. An application made by an agent on behalf of a taxpayer must be accompanied by a power of attorney authorizing the agent to sign for the taxpayer. If the agent is also authorized to represent the taxpayer before the Service, receive the original or a copy of correspondence concerning the request, or perform any other act(s) regarding the application on behalf of the taxpayer, the power of attorney must reflect such authorization(s). If the taxpayer is a member of an affiliated group that has elected to file a consolidated federal income tax return, a current Form 3115 submitted on behalf of the taxpayer must be signed by a duly authorized officer of the common parent. (See section 1.1502-77 of the regulations).

SEC. 7. INQUIRIES

Inquiries regarding this revenue procedure may be addressed to the Commissioner of Internal Revenue, Attention: CC:C:C:1, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

---

26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 82-33

SECTION 1. BACKGROUND

Rev. Proc. 82-22, page 469, this Bulletin, sets forth areas in which advance rulings or determination letters will not be issued by the Internal Revenue Service. Section 3 of Rev. Proc. 82-22 is entitled: Areas in Which Rulings or Determination Letters Will Not Be Issued.

SEC. 2. PROCEDURE

Rev. Proc. 82-22 is hereby amplified by deleting from section 3.06 the phrase "at the time of its sale," so that section 3.06 now reads as follows:

Sections 121 and 1034.—One-Time Exclusion of Gain from Sale of Principal Residence by Individual Who Has Attained Age 55; Rollover of Gain on Sale of Principal Residence.—Whether property qualifies as the taxpayer's principal residence.

SEC. 3. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 82-22 is amplified.

---

26 CFR 601.401: Employment taxes.
(Also Part I, Sections 3302, 3303, 3304, 3310, 6601; 31.3302(a)-1, 301.6601-1.)

Rev. Proc. 82-34

SECTION 1. PURPOSE

The purpose of this revenue procedure is to obsolete Rev. Proc. 79-10, 1979-1 C.B. 491.

SEC. 2. BACKGROUND

Rev. Proc. 79-10 states that employers that have made contributions to the unemployment fund of the State of New Hampshire for 1978 will be permitted to file their 1978 Forms 940, Employer's Annual Federal Unemployment Tax Return, as if the Secretary of Labor has not withheld certification of the State and its unemployment compensation law for 1978. However, it further states that if certification is later withheld by the Secretary of Labor, any affected employer will be liable for any additional tax due, plus interest under section 6601 of the Internal Revenue Code.

In Notice 82-12, page 359, this Bulletin, the Internal Revenue Service announced that the Secretary of Labor has informed the Secretary of the Treasury that the State of New Hampshire and the New Hampshire unemployment compensation law have been certified under sections 3304(c) and 3303(b), respectively, of the Code (Federal Unemployment Tax Act), for the tax year 1978.

SEC. 3. EFFECT ON NEW HAMPSHIRE EMPLOYERS

Employers that claimed valid credits under sections 3302(a) and 3302(b) of the Code, based on their contributions to the unemployment fund of the State of New Hampshire for 1978, are entitled to those credits and are not liable for any additional tax or interest as a result of the delay in issuing the certification.

SEC. 4. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 79-10 is obsolete.

SEC. 5. EFFECTIVE DATE

This revenue procedure is effective for contributions made by employers to the New Hampshire unemployment fund for 1978.

---

26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 82-35

SECTION 1. BACKGROUND

Rev. Proc. 82-22, page 469, this Bulletin, sets forth areas in which advance rulings or determination letters will not be issued by the Internal Revenue Service. Section 5 of Rev. Proc. 82-22 is entitled, Areas Under Exten-

sive Study in Which Rulings or Determination Letters Will Not Be Issued Until the Service Resolves the Issue Through Publication of a Revenue Ruling, Revenue Procedure, Regulations or Otherwise.

SECTION 2. PROCEDURE

Rev. Proc. 82-22 is hereby amended by adding the following to section 5:

Section 101—Certain Death Benefits—Whether proceeds of "self-insured" life and survivor benefit plans established through a trust qualified under section 501(c)(9) of the Code are excludable from the beneficiary's gross income as amounts paid by reason of the death of the insured under section 101(a).

SECTION 3. EFFECTIVE DATE

This revenue procedure will apply to all ruling requests on hand in the National Office on June 21, 1982, the date of publication of this revenue procedure in the Internal Revenue Bulletin, as well as to requests received thereafter.

SECTION 4. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 82-22 is amplified.

---

26 CFR 601.201: Rulings and determination letters.
(Also Part I, Section 1502; 1.1502-13.)

Rev. Proc. 82-36

SECTION 1. PURPOSE.

The purpose of this revenue procedure is to set forth a checklist questionnaire of the information needed and the guidelines used by the Commissioner of Internal Revenue in considering requests for consent to elect not to defer gain or loss on deferred intercompany transactions under section 1.1502-13(c)(3) of the Income Tax Regulations, and the time for filing these requests.

This revenue procedure modifies and supersedes Rev. Proc. 74-35, 1974-2 C.B. 490 and supersedes Rev. Proc. 76-14, 1976-1 C.B. 553.

SEC. 2. BACKGROUND.

.01 The consolidated return regulations generally require that gains or losses resulting from intercompany transactions be deferred. The concept of "deferred intercompany transactions" is an integral part of the over-all tax treatment of affiliated groups filing consolidated returns under section 1502 of the Internal Revenue Code. Deferral is required in most cases to clearly reflect consolidated taxable income. However, in certain circumstances, the Commissioner may exercise discretion and grant consent, under section 1.1502-13(c)(3) of the regulations, to a consolidated return group to elect not to defer gains or losses on deferred intercompany transactions.

.02 The Internal Revenue Service receives requests for consent to an election not to defer gain or loss on deferred intercompany transactions during consolidated return years in which the information furnished is not complete enough to justify approval of the election. In such cases it is necessary to secure additional facts from the taxpayer before the request can be considered. This checklist, which is substantially similar to the checklist set forth in Rev. Proc. 74-35, will facilitate the filing and handling of requests under section 1.1502-13(c)(3) of the regulations by specifying the information that should be included so that the application will be as complete as possible when originally filed. However, because the information necessary to rule on a particular case depends upon all the facts and circumstances, information in addition to that listed in this revenue procedure may be required.

.03 Section 4 sets forth certain additional factors and guidelines used by the Commissioner in considering requests for consent to elect not to defer gain or loss on any deferred intercompany transactions under section 1.1502-13(c)(3) of the regulations.

.04 Section 5 sets forth the time for filing an application for consent under section 1.1502-13(c)(3) of the regulations and is a restatement of Rev. Proc. 76-14.

.05 The authority and general procedures with respect to the issuance of advance rulings are set forth in Rev. Proc. 82-37, page 491, this Bulletin, and are applicable to requests under section 1.1502-13(c)(3) of the regulations.

SEC. 3. INFORMATION TO BE INCLUDED IN REQUEST FOR RULINGS UNDER SECTION 1.1502-13(c)(3) OF THE REGULATIONS

.01 Each of the items included in this Section must be specifically dealt with in the application. If an item is not applicable, the letters "N.A." must be inserted after that item to so indicate. It is requested that presentation of the information should follow the format of this revenue procedure as closely as possible.

.02 Information needed in order to make determination:

1. The date the affiliated group elected to file consolidated returns.

2. A comparison of consolidated taxable income with deferred intercompany gains or losses and without deferred intercompany gains or losses for the first taxable year for which the election would apply.

3. An analysis of intercompany transactions for the three taxable years immediately preceding the taxable year for which the election would apply. For purposes of this section, "analysis" shall include the number and a description of intercompany transactions and the dollar amounts thereof.

4. An analysis of the effect of not deferring intercompany gain or loss on the following items for the first taxable year to which the election would apply:

(a) Net operating loss carryovers.
(b) Capital loss carryovers.
(c) Investment and foreign tax credits in the current year as well as carryovers to the current year.

With respect to any carryovers referred to in item (a) through (c) above, the analysis should include amounts for each of the carryover years and the date of expiration of the losses or credits.

5. A statement as to whether any sales of property between members of the group that would be depreciable or depletable property in the hands o the purchasing member would resul in long-term capital gain to the selle member, taking into account the pr visions of sections 1245 and 1250 of th Internal Revenue Code relating gain from dispositions of certain d

preciable property or certain depreciable realty.

6. A statement as to whether any of the members involved in the deferred intercompany transactions are subject to the separate returns limitation year rules or the consolidated return change of ownership rules.

7. A statement as to the type or types of property involved in the election.

8. A statement as to the frequency of the intercompany transactions and whether they occur in the ordinary course of the taxpayer's business, providing examples thereof.

9. A complete statement as to the reasons why the election is being made and why the group believes it should not be required to defer gain or loss on deferred intercompany transactions.

SEC. 4. ADDITIONAL FACTORS AND GUIDELINES USED BY THE COMMISSIONER IN CONSIDERING REQUESTS FOR RULINGS UNDER SECTION 1.1502-13(c)(3) OF THE REGULATIONS.

.01 Whether it is difficult to account for deferred gains and losses accurately and, if so, please explain.

.02 Whether consolidated taxable income computed under an election not to defer gain or loss on intercompany transactions will differ by more than 10 percent from consolidated taxable income computed by deferring gain or loss for the taxable year of the proposed election not to defer.

.03 Whether the affiliated group will secure the benefit of any deduction, credit or other allowance that it would not otherwise secure if the gains or losses that are the subject of the election were deferred under section 1.1502-13(c)(3) of the regulations.

.04 Whether the gains and losses that are the subject of the election not to defer have resulted from arms-length charges or prices in intercompany transactions, notwithstanding the application of section 482 of the Code to the affiliated group.

SEC. 5. TIME FOR FILING AN APPLICATION FOR CONSENT UNDER SECTION 1.1502-13(c)(3) OF THE REGULATIONS.

.01 Section 1.1502-13(c)(3) of the regulations provides that applications for consent not to defer gain or loss on any deferred intercompany transactions must be filed with the Commissioner on or before the due date of the consolidated return (not including extensions of time) for the taxable year to which the election is to apply. An election shall, unless revoked with the consent of the Commissioner, apply to all members of the group for the consolidated return year for which made and all subsequent consolidated return years ending prior to the first year for which such group does not file a consolidated return.

.02 The filing requirement of section 1.1502-13(c)(3) of the regulations will be deemed satisfied where the election not to defer is timely filed with the Commissioner with an attachment containing all available information and stating that any omitted information has not been finalized and will be forwarded; and such omitted information is submitted not later than the earlier of the following two dates: (1) 90 days after the original due date of the return, or (2) the date the consolidated return is filed with the Internal Revenue Service Center where the taxpayer is required to file such return.

SEC. 6. TERMINATION OF CONSENT UNDER SECTION 1.1502-13(c)(3) OF THE REGULATIONS.

.01 Notwithstanding the granting of consent under section 1.1502-13(c)(3) of the regulations, the Service may, upon examination of tax returns for years subsequent to the year of election not to defer, terminate the election not to defer gains or losses if the conditions and circumstances under which the consent was granted have changed and it is determined that deferral is necessary in order to clearly reflect the consolidated taxable income under section 446 of the Code.

SEC. 7. EFFECT ON OTHER DOCUMENTS.

Rev. Proc. 74-35 is modified and superseded.

Rev. Proc. 76-14 is superseded.

---

26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 82-37

SECTION 1. PURPOSE

The purpose of this revenue procedure is to update Rev. Proc. 80-20, 1980-1 C.B. 633, which provides procedures for issuing rulings and determination and information letters, and for entering into closing agreements on specific issues involving the interpretation or application of the federal tax laws. It also tells taxpayers and their representatives where to send requests for rulings and determination and information letters. It gives the steps to follow so that requests may be handled more efficiently.

SEC. 2. SCOPE

This revenue procedure applies only to ruling requests, information letters, and closing agreements under the jurisdiction of the Associate Chief Counsel (Technical), and to requests for determination letters under the jurisdiction of field offices that relate to Code sections under the jurisdiction of the Associate Chief Counsel (Technical). The Chief Counsel through the Associate Chief Counsel (Technical) provides basic principles and rules for the uniform interpretation and application of the federal tax laws under the jurisdiction of the Associate Chief Counsel (Technical). The procedures for obtaining rulings, etc., that apply specifically to federal firearms taxes under subtitle E of the Internal Revenue Code are under the jurisdiction of the Bureau of Alcohol, Tobacco and Firearms. The procedures for obtaining rulings, determination letters, etc., on employee plans and exempt organizations are under the jurisdiction of the Assistant Commissioner (Employee Plans and Exempt Organizations). However, the jurisdiction of the Associate Chief Counsel (Technical) includes section 521 of the Code, on exemption of farmers' cooperatives from tax; section 526, on shipowners' protection and indemnity associations; section 527(a), (b), (c), (d), (e), and (g), on political organizations, and section 528, on certain homeowners' associations.

SEC. 3. CHANGES

.01 Changes have been made to reflect the reorganization of the Internal Revenue Service. See, in particular, Sec. 9.12, which provides that a request for a ruling is sent to the Associate Chief Counsel, Attn: CC:IND:S, Room 6545. See also sec. 9.19 and sec. 9.20, which provide that statements regarding certain section 6110 matters are addressed to the Chief, Bulletin and Disclosure Unit, CC:IND:S, Room 2613.

.02 The applicable provisions of Rev. Proc. 81-33, 1981-2 C.B. 564, have been incorporated into this revenue procedure.

.03 Sec. 9.05 contains an updated list of revenue procedures that provide specific guidelines for requesting rulings under certain Code sections.

SEC. 4. GENERAL PRACTICE AND DEFINITIONS

.01 The Service answers inquiries of individuals and organizations, when appropriate in the interest of sound tax administration, about their status for tax purposes and the tax effects of their acts or transactions. The National Office issues rulings in such matters.

.02 District Directors of Internal Revenue apply the statutes and tax treaties, regulations, revenue rulings, and other precedents published in the Internal Revenue Bulletin in determining tax liability, collecting taxes, and issuing information letters and determination letters in answer to taxpayers' inquiries or requests. For purposes of this revenue procedure, any reference to District Director or district office includes, when appropriate, the director of an Internal Revenue Service Center and the Director of the Foreign Operations District, or their respective offices.

.03 The word "taxpayer" includes all persons subject to any provision of the Internal Revenue Code and, when appropriate, their representatives. Any reference to National Office means only the Office of the Associate Chief Counsel (Technical).

.04 A "ruling" is a written statement issued to a taxpayer by the National Office that interprets and applies the tax laws to that taxpayer's specific set of facts. Rulings are issued only by the National Office, under the general supervision of the Associate Chief Counsel (Technical). Issuing rulings has been largely delegated to the Directors of the Corporation Tax Division and the Individual Tax Division.

.05 A "determination letter" is a written statement issued by a District Director in response to a written inquiry by a taxpayer which applies the principles and precedents previously announced by the National Office to a specific set of facts. A determination letter is issued only when a determination can be made on the basis of clearly established rules in the statute or regulations, or by a position in a ruling, opinion, or court decision published in the Internal Revenue Bulletin that specifically answers the question presented. A determination letter will not be issued if a determination cannot be made, for example, when the question presents a novel issue, or if the matter is excluded from the jurisdiction of a District Director under section 7 of this revenue procedure.

.06 An "information letter" is a statement issued either by the National Office or by a District Director that calls attention to a well-established interpretation or principle of tax law, without applying it to a specific set of facts. It may be issued if the request indicates that the taxpayer is seeking general information. If the request does not meet the requirements of section 9 of this revenue procedure, but the Service thinks that the general information may help the individual or organization, it may issue an information letter.

.07 A "revenue ruling" is an interpretation by the Service that has been published in the Internal Revenue Bulletin. It is the conclusion of the Service on how the law is applied to an entire set of facts. Revenue rulings are issued only by the National Office and are published for the information and guidance of taxpayers, Internal Revenue Service officials, and other interested parties.

.08 A "closing agreement" is an agreement between the Commissioner of Internal Revenue or the Commissioner's delegate and a taxpayer on a specific issue or issues or liability that is entered into under the authority in section 7121 of the Code. A closing agreement prepared in an office under the jurisdiction of the Associate Chief Counsel (Technical) is based on a ruling that has been signed by the Commissioner, or the Commissioner's delegate, which says that a closing agreement will be entered into on the basis of the holding of the ruling letter. Closing agreements are final, unless fraud, malfeasance, or misrepresentation of a material fact can be shown. Closing agreements may be entered into when it is advantageous to have the matter permanently and conclusively closed, or when a taxpayer can show good and sufficient reasons for an agreement and the government will sustain no disadvantage by its consummation. In appropriate cases, taxpayers may be asked to enter into a closing agreement as a condition to the issuing of a ruling. If, in a single case, closing agreements are requested for each of a number of taxpayers, such agreements are entered into only if the number of taxpayers is 25 or less. However, if the issue and holding are identical for all the taxpayers and they number more than 25, a "mass closing agreement" will be entered into with the taxpayer who is authorized by the others to represent the entire group.

SEC. 5. RULINGS ISSUED BY THE NATIONAL OFFICE

.01 *In income and gift tax matters,* the National Office issues rulings on prospective transactions and on completed transactions before the return is filed for them. However, the National Office will issue rulings after the return is filed if a ruling is required by section 367 of the Code and the ruling request is filed on time under that section. Further, see Rev. Proc. 79-63, 1979-2 C.B. 578, which concerns applications for extension of the time for making an election or application for relief pursuant to section 1.9100-1 of the regulations. If a request for an extension of time under section 1.9100-1 is submitted after the return is filed but before the return is examined the procedures under Rev. Proc. 82-37 are applicable. If an examination of the return has begun, or is being considered by an Appeals Office, the procedures of Rev. Proc. 82-38 page 503, this Bulletin are applicable. The National Office issues rulings on the exempt status of organizations under section 521. See Rev. Proc. 80-25, 1980-1 C.B. 667. The National Office ordinarily does not issue rulings if at the time the ruling is requested, the identical issue is involved in the taxpayer's return for an earlier period, and (1) that issue is being examined by a District Director or is being considered by an Appeals Office, or (2) that issue had been examined by a District Director or considered by an Appeals Office and the statutory period of limitation on assessment or refund of tax has not expired, or (3) a closing agreement covering the issue or liability has not been entered into by a District Director or by an Appeals Office. If a return dealing with an issue for a particular year is filed while a request for ruling on that issue is pending, the National Office will issue the ruling unless it is notified by the taxpayer that an examination of that issue or the identical issue on an earlier year's return has been started by a District Director. See section 9.06. However, even if an examination has begun, the National Office ordinarily will issue the ruling if the District Director agrees, by memorandum, to permit the ruling to be issued. The National Office does not issue rulings on the replacement of involuntarily converted property,even though replacement has not been made, if the taxpayer has filed a return for the tax year in which the property was converted. See section 7.05 on the District Directors' authority to issue determination letters in this connection. In addition, the National Office does not issue rulings on the classification of an organization if a return has been filed for the organization for an earlier period. The National Office also does not issue rulings on only part of an integrated transaction.

.02 *In estate tax matters*, the National Office issues rulings with respect to transactions affecting the estate tax of a decedent before the estate tax return is filed. If the estate tax return is due to be filed before the ruling is issued, the taxpayer should secure an extension of time for filing the return for the maximum period of six months, and notify the National Office Branch considering the request for ruling that an extension has been secured. If the return is filed before the ruling is issued, the taxpayer must disclose on the return that a ruling has been requested, attach a copy of the pending ruling request to the return, and notify the National Office that the return has been filed. The National Office will make every effort to issue the ruling within three months of the day on which the return was filed. If the ruling cannot be issued within that three-month period, the National Office will notify the District Director having jurisdiction of the return who may, by memorandum to the National Office, grant an additional period for the issuance of the ruling. The National Office will not rule on matters relating to the application of the estate tax to property or the estate of a living person.

1 *In generation-skipping transfer tax matters*, the National Office issues rulings on transactions that affect the generation-skipping transfer tax before the return is filed. Rulings are not issued until after the generation-skipping trust, or trust equivalent, has been established. Rulings are not issued on a generation-skipping transfer tax matter before the distribution or termination takes place. Notwithstanding the foregoing, the National Office will issue rulings regarding the application of the generation-skipping transfer tax effective date rules (section 2006(c) of the Tax Return Act of 1976, Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1, 365, as amended by section 702(n)(1) of the Revenue Act of 1978, Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1, 169) to wills, trusts, and trust equivalents in existence on June 11, 1976.

2 *In matters involving additional tax under section 2032A(c)*, the National Office issues rulings on prospective transactions and on completed transactions before the return is filed for those transactions.

.03 *In employment and excise tax matters*, the National Office issues rulings on prospective transactions and on completed transactions either before or after the return is filed for those transactions. In employment tax matters, generally the taxpayer is the person who employs the worker. However, if the worker asks for the ruling, both the worker and the person who employs the worker are considered to be the taxpayer and both are entitled to the ruling. The National Office usually will not issue rulings if at the time the ruling is requested, the identical issue is involved in the taxpayer's return for an earlier period and (1) that issue is under examination by a District Director or under consideration by an Appeals office, or (2) that issue has been examined by a District Director or considered by an Appeals office and the statutory period of limitation on assessment or refund of tax has not expired, or (3) a closing agreement covering the issue or liability has not been entered into by a District Director or by an Appeals office. However, if a District Director began an examination of the issue involved in the ruling request, the National Office usually will issue the ruling if the District Director agrees, by memorandum, to permit the ruling to be issued.

.04 *In administrative provisions matters*, the National Office issues rulings on issues arising under the Internal Revenue Code and related statutes, and the regulations thereunder, that relate primarily to the time, place, manner, and procedures, for reporting and paying taxes; assessing and collecting taxes (including interest and penalties); abating, crediting, or refunding overassessments or overpayments of tax; and filing information returns. Rulings ordinarily are not issued, if at the time the ruling is requested, the identical issue is involved in the taxpayer's return for an earlier period and (1) that issue is being considered by a District Director or (2) that issue has been considered and the statutory period of limitation on assessment or refund of tax has not expired, or (3) a closing agreement covering the issue or liability has not been entered into. If a return involving an issue for a particular year is filed while a request for a ruling on that issue is pending, the National Office will issue the ruling unless an examination of that issue or an examination of the identical issue on an earlier year's return has been started by a District Director. But, even if consideration has begun, the National Office ordinarily will issue the ruling if the District Director agrees, by memorandum, to permit the ruling to be issued. Rulings ordinarily are not issued if at the time the ruling is requested, the identical issue is involved in the taxpayer's return for an earlier period and (1) that issue is being considered by an Appeals Office, or (2) that issue has been considered by an Appeals Office and the statutory period of limitation on assessment or refund of tax has not expired, or (3) a closing agreement covering the issue or liability has not been entered into.

.05 The National Office does not issue rulings to business, trade, or industrial associations, or to similar groups concerning the application of the tax laws to members of the group. It may, however, issue rulings to these groups or associations on their own tax status or liability, if the tax status or liability is not an issue that is being examined by any field office (including consideration by any Appeals Office) for the same taxpayer for the same or an earlier period under the conditions stated in section 5.

.06 Pending the adoption of regulations (either temporary or final) that interpret the provisions of any act, the issuing of rulings will be considered under the following conditions:

1 If the ruling request presents an issue on which the answer seems clear by applying the statute to the facts, a ruling will be issued under the usual procedures.

2 If the ruling request presents an issue on which the answers seems reasonably certain but not entirely free from doubt, a ruling will be issued only if it is established that a business emergency requires a ruling or that unusual hardship will result from failure to obtain a ruling. If the taxpayer believes that a business emergency exists or that an unusual hardship will result from failure to obtain a ruling, the taxpayer should submit with the request a separate letter stating the facts necessary for the Service to make a determination. In this connection, the Service will not consider a "business emergency" to result from circumstances under the taxpayer's control, such as, scheduling within an inordinately short time the closing date for a transaction or a meeting of the board of directors or the shareholders of a corporation. However, if the ruling request presents an issue that cannot be reasonably resolved before regulations are issued, a ruling will not be issued.

SEC. 6. DETERMINATIONS UNDER SECTION 999(d) OF THE CODE

Under Rev. Proc. 77-9, 1977-1 C.B. 542, procedures, the National Office issues determinations under section 999(d) of the Code that may deny certain benefits of the foreign tax credit, deferral of earnings of foreign subsidiaries, and domestic international sales corporation (DISC) to a person, if that person, or a member of a controlled group (within the meaning of section 993(a)(3)) that includes that person, or a foreign corporation of which a member of the controlled group is a United States shareholder, agrees to participate in or cooperate with an international boycott.

SEC. 7. DETERMINATION LETTERS ISSUED BY DISTRICT DIRECTORS

.01 *In income and gift tax matters,* District Directors issue determination letters in response to taxpayers' written requests on completed transactions that affect returns over which they have examination jurisdiction. This applies only if the question presented is specifically answered by statute or regulation, or by the position stated in a ruling, opinion, or court decision published in the Internal Revenue Bulletin. A determination letter usually is not issued for a question concerning a return to be filed by the taxpayer if the same question is involved in a return already filed. District Directors do not issue determination letters on the tax consequences of prospective or proposed transactions, except as provided in section 7.05.

.02 *In estate tax matters,* District Directors issue determination letters in response to written requests affecting the estate tax returns of decedents that they will examine, but only if the question presented is specifically answered by statute or regulation, or by the position stated in a ruling, opinion, or court decision published in the Internal Revenue Bulletin. District Directors do not issue determination letters on matters concerning the application of the estate tax to property or the estate of a living person.

1 *In generation-skipping transfer tax matters,* District Directors issue determination letters in response to written requests affecting the generation-skipping transfer tax returns that they will examine, but only if the questions presented are specifically answered by statute or regulation, or by a position stated in a ruling, opinion, or court decision published in the Internal Revenue Bulletin. District Directors do not issue determination letters or matters concerning the application of the generation-skipping transfer tax before the distribution or termination takes place.

.03 *In employment and excise tax matters,* District Directors issue determination letters on completed transactions in response to written requests from taxpayers over which they have examination jurisdiction, but only if the question presented is specifically answered by statute or regulation, or by the position stated in a ruling, opinion, or court decision published in the Internal Revenue Bulletin.

.04 Notwithstanding the provisions of sections 7.01, 7.02, and 7.03, a District Director will not issue a determination letter in response to a request that presents a question specifically answered by statute or regulation, or by the position stated in rulings, etc., published in the Internal Revenue Bulletin, if (1) it appears that the taxpayer has directed a similar inquiry to the National Office, (2) the same issue involving the same taxpayer is pending in a case before an Appeals office, (3) the determination letter is requested by an industry, trade association, or similar group, or (4) the request involves an industry-wide problem. Under no circumstances will a District Director issue a determination letter unless it is clearly shown that the request concerns a return that has been filed or is required to be filed over which the District Director has or will have examination jurisdiction. Notwithstanding the provisions of section 7.03, a District Director will not issue a determination letter on an employment tax question if the specific question for the same taxpayer has been or is being considered by the Central Office of the Social Security Administration or the Railroad Retirement Board. Nor will District Directors issue determination letters for determination of a constructive sales price under section 4216(b) or 4218(e) of the Code. The National Office, however, will issue rulings in this area. See section 8.03.

.05 District Directors issue determination letters on the replacement of involuntarily converted property under section 1033 even though the replacement has not been made, if the taxpayer has filed an income tax return for the year in which the property was involuntarily converted.

.06 A request received by a District Director on a question concerning an income, estate, or gift tax return already filed will, in general, be considered in connection with the examination of the return. If a response is made to such a request before the return is examined, it will be considered a tentative finding in any later examination of that return.

SEC 8. DISCRETIONARY AUTHORITY TO ISSUE RULINGS AND DETERMINATION LETTERS

.01 The Service ordinarily will not issue rulings or determination letters in certain areas because of the factual nature of the problem involved, or for other reasons. Rev. Proc. 82-22, page 469, this Bulletin, provides a list of these areas. This list is not all inclusive, since the Service may decline to issue a ruling or a determination letter on other questions, whenever warranted by the facts or circumstances of a particular case. The National Office and District Directors may, when it is considered appropriate and in the best interest of the Service, issue information letters calling attention to well-established principles of tax law.

.02 A ruling or a determination letter is not issued on alternative plans of proposed transactions or on hypothetical situations.

.03 The National Office will issue rulings in all cases on prospective or future transactions if the law or regulations require a determination of the effect of a proposed transaction for tax purposes, as in a transfer under section 1491 and 1492 of the Code. The National Office will issue rulings on all transfers described in section 367(a)(1) if the request is filed within 183 days after the beginning of the transfer. The National Office also will issue rulings in all cases on the determination of a constructive sales price under section 4216(b) or 4218(e).

SEC 9. INSTRUCTIONS TO TAXPAYER

.01 The taxpayer should submit a request for a ruling or a determination letter in duplicate if (1) more than one issue is presented in the request, or if (2) a closing agreement is requested on the issue presented. It is not necessary to submit requests in duplicate under other circumstances.

.02 A request for a ruling or determination letter and any factual information submitted at a later time must be accompanied by a declaration in the following form. "Under penalties of perjury, I declare that I have examined this request, including accompanying documents, and to the best of my knowledge and belief, the facts presented in support of the requested ruling or determination letter are true, correct, and complete." The declaration may not be made by the taxpayer's representative. It must be signed by the person or persons on whose behalf the request is made. The person who must sign for a corporate taxpayer must be an officer of the corporate taxpayer who has personal knowledge of the facts. The officer must be one whose duties are not limited to obtaining a ruling or determination letter from the Service. The person signing for a trust or partnership must be a trustee or partner who has personal knowledge of the facts.

.03 If more than one issue is presented in a request for a ruling, the Service generally will issue a single ruling letter. However, the taxpayer may request a separate ruling letter on any of the issues. Unless the Service determines that it is not feasible or not in the best interest of the Service to comply with such a request, it will issue separate ruling letters.

.04 When multiple issues are involved in a single factual situation and separate letters requesting rulings are submitted, a statement to this effect must be included in each ruling letter request. The Service in issuing each ruling will state that separate rulings have been issued or requests for rulings are pending.

.05 Each request for a ruling or a determination letter must contain a complete statement of all of the facts relating to the transaction. Such facts include: names, addresses, and taxpayer identification numbers of all interested parties; the location of the District Office that has or will have jurisdiction over the return; a full and precise statement of the business reasons for the transaction; and a carefully detailed description of the transaction. (The term "all interested parties" does not mean that a list is required of all shareholders of a widely-held corporation requesting a ruling relating to a reorganization, or a list of employees where a large number may be involved.) In addition, true copies of all contracts, wills, deeds, agreements, instruments, and other documents in the transaction must be submitted with the request. Original documents, such as contracts, wills, etc., should not be submitted because they become part of the Service's file and will not be returned. All material facts in documents must be included in the taxpayer's letter requesting a ruling or in supplemental letters, and not merely incorporated by reference, and must be accompanied by an analysis of their bearing on the issue or issues, specifying the provisions that apply. Material facts furnished to the Service by telephone or orally at a conference must be promptly confirmed by letter to the Service with a declaration in the form described in section 9.02. This confirmation must be furnished within 21 calendar days to be considered part of the request. An extension of the 21-day period will be granted only if justified in writing by the taxpayer and approved by the Chief or Assistant Chief of the Branch to which the case is assigned. A request for extension should be submitted before the end of the 21-day period. If unusual circumstances close to the end of the 21-day period make a written request impractical, within the 21-day period the National Office should be told of the problem and that the written request for extension will be coming soon. Such a request must be sent promptly. The taxpayer or taxpayer's representative will be told promptly and later in writing of the approval or denial of the requested extension. There is no right of appeal to a denial of an extension request. Because the purpose of these procedures is to speed up the ruling process, the taxpayer is encouraged to submit the required relevant material promptly. Therefore, requests for extensions should be justified by compelling facts and circumstances. If the Service is not made aware, as provided above, of problems in meeting the 21-day period, or if the request is not sent promptly after the National Office is notified of problems in meeting the 21-day period, the Service will process the case on the assumption that no further submission will be received.

Specific guidelines for requesting rulings under certain code sections follow: Rev. Proc. 79-4, 1979-1 C.B. 483 (guidelines for submitting requests for rulings under sections 103 and 7478 on whether interest on certain governmental obligations can be excluded from the gross income of those who own them); Rev. Proc. 68-11, 1968-1 C.B. 761 (guidelines for a ruling request under section 117); Rev. Proc. 81-62, 1981-2 C.B. 684 (guidelines concerning a request for a ruling under section 302 or 311); Rev. Proc. 81-68, 1981-2 C.B. 723 (guidelines concerning a request for a ruling under section 332, 334(b)(1) or 334(b)(2)); Rev. Proc. 81-52, 1981-2 C.B. 625 (guidelines concerning a request for a ruling under section 337); Rev. Proc. 81-42, 1981-2 C.B. 611 (guidelines concerning a request for a ruling under section 331 or 346); Rev. Proc. 81-57, 1981-2 C.B. 674 (guidelines concerning a request for a ruling under section 351); Rev. Proc. 81-41, 1981-2 C.B. 605 (guidelines concerning a request for a ruling under section 355); Rev. Proc. 68-23, 1968-1 C.B. 821, Rev. Proc. 69-19, 1969-2 C.B. 301, Rev. Proc. 74-36, 1974-2 C.B. 491, Rev. Proc. 76-20, 1976-1 C.B. 560, Rev. Proc.77-5, 1977-1 C.B. 536, Rev. Proc. 77-17, 1977-1 C.B. 577, Rev. Proc. 78-27, 1978-2 C.B. 526, Rev. Proc. 78-28, 1978-2 C.B. 526, and Rev. Proc. 80-14, 1980-1 C.B. 617 (guidelines concerning a request for a ruling under section 367). However, see section 7.367 of the Temporary Income Tax Regulations under the Tax Reform Act of 1976, which superseded the previously mentioned revenue procedures relating to section 367, to the extent of overlapping rules. Rev. Proc. 75-29, 1975-1 C.B. 754, Rev. Proc. 76-4, 1976-1 C.B. 543, Rev. Proc. 76-24, 1976-1 C.B. 563, Rev. Proc. 76-44, 1976-2 C.B. 668, and Rev. Proc. 77-4, 1977-1 C.B. 536 (guidelines for changes to closing agreements as a condition to issuing rulings under section 367); Rev. Proc. 81-60, 1981-2 C.B. 680 (guidelines concerning a request for a ruling under section 368(a)(1)(E)); Rev. Proc. 77-30, 1977-2 C.B. 539, Rev. Proc. 78-18, 1978-2 C.B. 491, Rev. Proc. 78-23, 1978-2 C.B. 503, and Rev. Proc. 77-37, 1977-2 C.B. 568 as amplified by Rev. Proc. 77-41, 1977-2 C.B. 574 (guidelines concerning requests for rulings handled by the Reorganization Branch of the Corporation Tax Division); Rev. Proc. 72-13, 1972-1 C.B. 735, Rev. Proc. 74-17, 1974-1 C.B. 438, and Rev. Proc. 75-16, 1975-1 C.B. 676 (guidelines on classification of limited partnerships); Rev. Proc. 79-1, 1979-1 C.B. 481 (guidelines on classification of organizations as liquidating trusts); Rev. Proc. 79-63, 1979-2 C.B. 578 (factors considered and information needed for granting extensions under section 1.9100-1 of the Income Tax Regulations). If the request concerns a corporate distribution, reorganization, or similar transaction, the corporate balance sheet and profit and loss statement closest to the date of the transaction should be submitted. (If the request relates to a prospective transaction, the most recent balance sheet and profit and loss statement should be submitted.)

.06 The request must contain a statement of whether, to the best of the knowledge of the taxpayer and the taxpayer's representative(s), if any, the identical issue is in a return of the taxpayer (or of a related taxpayer within the meaning of section 267 of the Code, or a member of an affiliated group of which the taxpayer is also a member within the meaning of section 1504) and, if so, whether the issue (1) is being examined by a District Director, (2) has been examined and the statutory period of limitation on assessment or refund of tax has not expired or a closing agreement covering the issue or liability has not been entered into by a District Director, (3) is being considered by an Appeals office in connection with the taxpayer's return for an earlier period, or that issue has been considered by an Appeals office and the statutory period of limitation on assessment or refund of tax has not expired or a closing agreement covering the issue or liability has not been entered into by an Appeals office, or (4) is pending in litigation in a case involving the taxpayer or a related taxpayer. The request must contain a statement whether, to the best of the knowledge of the taxpayer and the taxpayer's representative(s), the identical or similar issue has been ruled on by the Service to the taxpayer or to the taxpayer's predecessor and, if so, when and with what results. If after the request is filed but before a ruling is issued, the taxpayer knows that an examination of the issue by a District Director has been started, the taxpayer must notify the National Office of such action. If a return is filed before a ruling is received from the National Office concerning the return, a copy of the request must be attached to the return. This alerts the District Office and avoids premature District action on the issue.

If the request deals with only one step of a larger integrated transaction, the facts, circumstances, etc., relating to the entire transaction must be submitted.

.07 As an alternative procedure for the issuing of rulings on prospective transactions, the taxpayer may submit a summary of the facts considered to be controlling the issue, in addition to the complete statement required for ruling requests by section 9.05. If the National Office agrees with the summary, the National Office will use it as the basis for the ruling. To use this procedure, the taxpayer should submit the following with the request for a ruling:

1 A complete statement of facts about the transaction, together with related documents, as required by section 9.05; and

2 A summary statement of the facts believed to be controlling in reaching the requested conclusion. When the taxpayer's statement of controlling facts is accepted, the Service will base its ruling on these facts and only this statement will ordinarily be incorporated in the ruling letter. It is emphasized, however, that:

(a) The taxpayer may elect this procedure for a "two-part" ruling request. It is not to be considered a required substitute for the regular procedures provided by this revenue procedure;

(b) The taxpayer's rights and responsibilities are the same under the "two-part" ruling request procedure as those provided in this revenue procedure;

(c) The Service reserves the right to rule on the basis of a more complete statement of facts it considers controlling and to seek more information in developing facts and restating them; and

(d) The "two-part" ruling request procedure will not apply if it is inconsistent with other procedures, such as those dealing with: requests for permission to change accounting methods or periods; applications for recognition of exempt status under section 521 of the Code; or rulings on employment tax status.

.08 If the taxpayer asserts a particular determination, an explanation of the grounds for the assertion must be furnished, together with a statement of relevant authorities in support of the taxpayer's views. Even though the taxpayer is urging no particular determination of a proposed or prospective transaction, the taxpayer's views on the tax results of the proposed action and a statement of relevant authorities to support those views must be furnished. In addition, the taxpayer is encouraged to inform the Service of, and discuss the implications of, any legislation, or tax treaties, court decisions, regulations, revenue rulings or revenue procedures that the taxpayer determines to be contrary to the position advanced. If the taxpayer determines that there are no contrary authorities, a statement to this effect would be helpful in the ruling request. Identification and discussion of contrary authorities will generally enable Service personnel to arrive more quickly at a full understanding of the issue and the relevant authorities. There is a further advantage to the taxpayer. When Service personnel receive the request, they will have before them the taxpayer's thinking on the effect and applicability of contrary authorities. Such information should, therefore, make research easier and lead to earlier action by the Service. Conversely, failure to disclose and distinguish significant contrary authorities may result in requests for additional information memoranda which will delay action on the ruling request.

.09 To assist the National Office in making the deletions, required by section 6110(c) of the Code, from the text of rulings and determination letters, to be made open to public inspection under section 6110(a), a deletions statement must accompany requests. The statement must either state that no information other than names, addresses, and identifying numbers need be deleted, or if more information is proposed to be deleted, the statement must indicate the deletions proposed by the person requesting the ruling or determination letter. If the latter alternative is chosen, the statement must be made in a separate document, and it must be accompanied by a copy of the request for a ruling or determination letter and supporting documents, on which must be shown by the use of brackets, the material that the person making the request believes should be deleted pursuant to section 6110(c). The statement of proposed deletions must indicate the statutory basis, under section 6110(c), for each proposed deletion. The statement of proposed deletions must not appear or be referred to anywhere in the request for a ruling or determination letter. If the person making the request decides to ask for additional deletions before the ruling or determination letter is issued, additional statements may be submitted. The procedures in this paragraph also apply to additional information that is submitted after the initial request.

.10 A request by or for a taxpayer must be signed by the taxpayer or the taxpayer's authorized representative. If the request is signed by a representative, or if the representative is to appear before the Service in connection with the request, the representative must be:

1 an attorney who is a member in good standing of the bar of the highest court of any state, possession, territory, commonwealth, or the District of Columbia, and who files with the Service a written declaration that he or she is currently qualified as an attorney and is authorized to represent the taxpayer;

2 a certified public accountant who is qualified to practice in any state, possession, territory, commonwealth, or the District of Columbia, and who files with the Service a written declaration that he or she is currently qualified as a certified public accountant and is authorized to represent the taxpayer; or

3 a person, other than an attorney or certified public accountant who is currently enrolled to practice before the Service, and who files with the Service a written declaration that he or she is currently enrolled (including in the declaration either the enrollment number or the expiration date of the enrollment card) and is authorized to represent the taxpayer. (See Treasury Department Circular No. 230 (31 CFR Part 10), revised, 1966-2 C.B. 1171, amended 1967-1 C.B. 433, and 1970-2 C.B. 644, for the rules on who may practice before the Service.) These requirements do not apply to an individual representing his or her full-time employer, or to a bona fide officer, administrator, administratrix, trustee, etc., representing a corporation, trust, estate, association, or organized group. An unenrolled preparer of a return (other than an attorney or certified public accountant referred to in (1) and (2) above) who is not a full-time employee or a bona fide officer, administrator, administratrix, trustee, etc., may not represent a taxpayer in connection with a ruling or a determination letter. Any authorized representative, whether or not enrolled to practice, must also comply with the conference and practice requirements of the Statement of Procedural Rules (26 CFR 601). Form 2848, Power of Attorney, and Form 2848-D, Authorization and Declaration, may be used with regard to rulings, closing agreements, and determination letters requested under this revenue procedure.

.11 If a taxpayer has more than one representative, it is sufficient to send a copy of the ruling to any one of them. Copies of rulings will be sent to no more than two representatives, provided that they are located at different mailing addresses. If a taxpayer does not designate which representative is to receive a copy of the ruling, a copy of the ruling will be sent to the first representative named on the latest power of attorney. If the original of the ruling is to be sent to a representative, the power of attorney should contain a statement to that effect and designate the mailing address of the representative.

.12 A request for a ruling letter by the National Office should be sent to the Internal Revenue Service, Associate Chief Counsel (Technical), Attention CC:IND:S, Room 6545, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. A request for a determination letter should be sent to the District Director of Internal Revenue whose office has or will have examination jurisdiction over the taxpayer's return.

.13 If a request for a ruling or determination letter does not comply with all the provisions of this revenue procedure, the request will be acknowledged, and the requirements that have not been met will be pointed out. If a request for a ruling lacks essential information, the taxpayer will be told that if the information is not received within 30 calendar days, the request will be closed. If the information is received after the request is closed, it will be reopened and treated as a new request as of the date the essential information is received. A request for a ruling letter sent to the District Director that does not comply with the provisions of this revenue procedure will be returned by the District Director for corrections before it is sent directly to the National Office.

.14 A taxpayer who wants to have a conference on the issue or issues involved should indicate this in writing when, or soon after, filing the request.

.15 The Service processes requests for ruling and determination letters in regular order and as expeditiously as possible. Consideration of a request for processing ahead of its regular order, or by a specified time, delays the processing of other matters. Requests for processing ahead of the regular order must be made in writing, preferably in a separate letter sent with, or soon after, the request. If the request is not made in a separate letter, then the letter in which the request is made should say, at the top of the first page: "Expeditious Handling Is Requested. See page of this letter." The request should give a compelling need for such treatment. The Service cannot give assurance that any letter will be processed by the time requested. For example, the scheduling of a closing date for a transaction or a meeting of the board of directors or shareholders of a corporation, without regard for the time it may take to obtain a ruling or determination letter, will not be considered sufficient reason for handling a request ahead of its regular order. Nor will the possible effect of fluctuation in the market price of stocks on a transaction be considered sufficient reason for handling a request out of order. Requests by telegram will be treated in the same manner as requests by letter. Ruling and determination letters ordinarily are not issued by telegram. A request for expeditious handling will not cause the Communications Branch to route the case to the Ruling Branch ahead of normal processing; and a request for expeditious handling will not be considered until the underlying ruling request has been found to satisfy the section 6110 requirements.

.16 The Director, Individual Tax Division, has primary responsibility for providing basic principles for uniform interpretation and application of the federal tax laws in those areas involving: income taxes of noncorporate taxpayers (including individuals, partnerships, estates, and trusts); political organizations under section 527 (except subsection (f)); employment taxes and taxes on self-employment income; estate, gift, generation-skipping transfer, and certain excise taxes; and procedure and administration provisions of the Internal Revenue Code, except those that apply specifically to employee plans, exempt organizations, and actuarial determinations.

.17 The Director, Corporation Tax Division, has primary responsibility for providing basic principles of and rules for uniform interpretation and application of the federal tax laws in those areas involving: income taxes and earnings and profits of corporate taxpayers; changes in methods and periods of accounting, depreciation, depletion, valuation and other engineering issues; the taxable status of exchanges and distributions in connection with corporate organizations, reorganizations, and liquidations; and the exemption of farmers' cooperatives (under section 521), shipowners' protection and indemnity associations (under section 526), and certain homeowners associations (under section 528).

.18 A taxpayer may obtain information regarding the status of a request by calling the person whose name and telephone number is shown on the acknowledgement of receipt of the request.

.19 If, after receiving the notice under section 6110(f)(1) of the Code of intention to disclose the ruling or determination letter (including a copy of the version proposed to open to public inspection and notations of third-party communications under section 6110(d)), the person requesting the ruling or determination letter wants to protest the disclosure of certain information in the ruling or determination letter, that person must within 20 calendar days send a written statement to the Internal Revenue Service, Chief, Bulletin and Disclosure Unit, Attention, CC:IND:S, Room 2613, 1111 Constitution Avenue, Washington, D.C. 20224, identifying those deletions that the Service has not made and that the person representing the ruling or determination letter believes should have been made. That person must also submit a copy of the version of the ruling or determination letter proposed to be open to public inspection on which the person indicates, by use of brackets, the deletions proposed by the taxpayer that have not been made by the National Office. Generally, the Service will not consider the deletion under this subparagraph of any material that the taxpayer did not propose to be deleted before the ruling or determination letter was issued. Within 20 days after it receives the response to the notice under section 6110(f)(1), the National Office will mail to that person its final administrative conclusion regarding the deletions to be made. The taxpayer does not have the right to a conference to resolve any disagreements concerning material to be deleted from the text of the ruling. However, these matters may be taken up at any conference that is otherwise scheduled regarding the request.

.20 After receiving the notice under

section 6110(f)(1) of the Code of intention it disclose (but no later than 60 calendar days after the notice is mailed), the person requesting a ruling or determination letter may send a request for delay of public inspection under either section 6110(g)(3) or section 6110(g)(3) and (4). The request for delay must be sent to the Internal Revenue Service, Chief, Bulletin and Disclosure Unit, Attention CC:IND:S, Room 2613, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. A request for delay must contain the date on which it is expected that the underlying transaction will be completed. The request for delay under section 6110(g)(4) must contain a statement from which the Commissioner may determine that there are good reasons for the delay.

.21 A taxpayer who receives a ruling or determination letter before filing a return about any transaction that has been consummated and that is relevant to the return being filed should attach a copy of the ruling or determination letter to the return when it is filed.

.22 Protests to adverse rulings under section 367 will be processed as follows:

Under Rev. Proc. 77-5, 1977-1 C.B. 536, a taxpayer may protest an adverse, or terms and conditions, ruling letter issued on or after January 31, 1977, under section 367(a)(1) of the Code. This includes a ruling on an exchange described in section 367(b) that began before January 1, 1978, or section 1042(e) of the Tax Reform Act of 1976 (Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1, 115). The protest may not be made later than the close of the 45th calendar day after the date of the ruling letter. A protest is considered made on the date of the postmark of a letter of protest sent to the Associate Chief Counsel (Technical), or the date that the letter is hand delivered to the Service. The letter must include: (1) a copy of the ruling letter; (2) the reasons for the protest including, if applicable, (a) the grounds for asserting that none of the principal purposes for the exchange is the avoidance of federal income tax, (b) the grounds for asserting that the terms and conditions in the ruling letter pursuant to which an exchange to which section 367 applies will be considered not to be in pursuance of tax avoidance are not reasonable, and (c) the arguments supporting a protest of the validity of a ruling position published by the Service, such as a position in the guidelines announced in Rev. Proc. 68-23, 1968-1 C.B. 821 (factual material not previously submitted and considered by the Service should not be included in the protest); (3) a statement of whether a conference is desired; and (4) names of persons (including authorized representatives) expected to attend the conference, if a conference is granted. The Associate Chief Counsel (Technical) will establish an ad hoc advisory board to consider each protest, whether or not a conference is requested. The taxpayer will be granted one conference upon request. Whether or not such a request is made the board may ask for one or more conferences or for written submissions. The taxpayer will be notified of the time, date, and place of the conference, and of the names of the members of the board. The board will consider all materials submitted in writing by the taxpayer and oral arguments presented at the conference. The board will make its recommendation to the Associate Chief Counsel (Technical) who will make a decision in the matter. Any oral arguments made at a conference by the taxpayer, which have not previously been submitted to the Service in writing, may, if desired, be submitted to the Service in writing if postmarked no later than the end of the 7th calendar day after the day of the conference. The taxpayer will be informed of the decision of the Associate Chief Counsel (Technical) by certified or registered mail.

.23 For appeal procedures with regard to adverse determination letters under section 521 of the Code and revocation or modification of exemption rulings and determination letters under section 521, see Rev. Proc. 80-25.

Sec. 10. Handling of Ruling Requests

.01 Within 21 calendar days after a ruling request is received in the branch, Service personnel will contact the taxpayer to discuss informally the procedural and substantive issues in the ruling request.

.02 The following subject matters are included in the 21 calendar day procedure:

1 Individual Income Tax Branch
  (a) Partnerships and trusts
  (b) Code section 103 (issues under its jurisdiction)
  (c) Real estate investment trusts
  (d) Stock options
  (e) Charitable remainder trusts
  (f) Pooled income funds

2 All matters within the jurisdiction of the Corporation Tax Branch, except cases
  (a) involving a request for change in accounting methods or periods,
  (b) relating to the last-in, first-out method of computing inventory.
  (c) concerning insurance issues on contracts with reserves based on segregated asset accounts.
  (d) concerning insurance issues requiring actuarial computations.

3 All matters within the jurisdiction of the Estate and Gift, Wage, Excise and Administrative Provisions Branch, except ruling requests from individuals for employment status submitted on Forms SS-8.

4 All matters within the jurisdiction of the Engineering and Valuation Branch (except cases involving a request for a change in accounting methods), and Reorganization Branch.

.03 Procedures to be followed regarding ruling requests are:

1 Within 21 calendar days after a ruling request has been received in the branch having jurisdiction, a representative of the branch will contact the taxpayer to discuss the procedural issues in the ruling requests covered by this procedure. Considering the complexity of some cases or the number of issues involved, it may not be possible for the branch representative to discuss the substantive issues in the ruling request during this initial contact. However, when possible, as to each issue coming within the jurisdiction of the branch, the branch representative will tell the taxpayer:

(a) whether the branch representative will recommend the Service rule as the taxpayer requested, rule adversely on the matter, or not rule;

(b) whether the taxpayer should submit additional information or representations to enable the Service to rule on the matter; or

(c) whether because of the nature of the transaction, or the issue presented, a tentative conclusion on the issue cannot be reached.

2 When the rulings requested involve matters within the jurisdiction of more than one branch or more than one office in the same branch, a representative of the branch that received the original ruling request will tell the taxpayer within the initial 21 calendar day contact period: (1) that the rulings requested involving matters within the jurisdiction of another branch or another office in the same branch have been referred to the other branch or office for consideration; and (2) that a representative of the other branch or office will contact the taxpayer within 21 calendar days after receiving the referral to informally discuss the procedural and, to the extent possible, the substantive issues if covered by this procedure.

3 If something less than a fully favorable ruling is indicated, the branch representative will tell the taxpayer if minor modifications of the transaction or adherence to certain published positions will warrant the issuing of a favorable ruling. In addition, the branch representative may tell the taxpayer what representations must be furnished in a document to comply with the requirements of the Service. However, the branch representative will not suggest precise changes that would materially alter the form of the proposed transaction. If, at the conclusion of the discussion, the branch representative determines that a meeting in the National Office would better serve the purpose of developing or exchanging information, a meeting will be offered and an early meeting date arranged. This meeting will not be the taxpayer's conference of right, as described in this revenue procedure.

4 The Service will not be bound by the informal opinion expressed by the branch representative or any other authorized Service representative under this procedure, and such an opinion cannot be relied upon as a basis for granting retroactive relief under the provisions of section 7805(b) of the Code.

5 The ruling request will then be processed under present procedures.

SEC. 11. CONFERENCES IN THE NATIONAL OFFICE

.01 A taxpayer may request a conference only in connection with a ruling request. Normally, a conference is scheduled only when the National Office considers it to be helpful in deciding the case or when an adverse decision is indicated. If conferences are being arranged for more than one request for a ruling involving the same taxpayer, they will be scheduled so as to cause the least inconvenience to the taxpayer. If a conference has been requested, the taxpayer will be notified by telephone, if possible, of the time and place of the conference. The conference must be held within 21 calendar days after such contact has been made. Procedures for requesting an extension of the 21-day period and notifying the taxpayer or the taxpayer's representative of the Service's decision are the same as those stated in section 9.05.

.02 A taxpayer is entitled, as a matter of right, to only one conference in the National Office unless one of the circumstances discussed in section 11.06 develops. This conference normally will be held at the branch level of the appropriate division in the office of the Associate Chief Counsel (Technical) and will be attended by a person who, at the time of the conference, has authority to sign the ruling letter for the branch chief in the case being discussed. When more than one branch has taken an adverse position on an issue within its jurisdiction presented in a ruling request, or when the position ultimately adopted by one branch will affect another branch's determination, a representative from each branch with the authority to sign for the branch chief will attend the conference. If more than one subject is to be discussed at the conference, the discussion will constitute a conference on each subject. In order to promote a free and open discussion of the issues, the conference usually will be held after the branch has had an opportunity to study the case. However, at the request of the taxpayer or representative, the conference of right may be held at an earlier stage in the consideration of the case than the Service ordinarily would designate. No taxpayer has a "right" to appeal the action of a branch to a division director or to any other official of the Service.

.03 In employment tax matters, only the party entitled to the ruling is entitled to a conference.

.04 Since conference procedures are informal, no tape, stenographic, or other verbatim recording of a conference will be made.

.05 The senior Service representative present at the conference insures that the taxpayer has full opportunity to present views on all of the issues that are in question. The Service representative explains the Service's tentative decision on the substantive issues and the reasons for that decision. If the taxpayer advances prospective application under section 7805(b) of the Code, the Service representative will discuss the tentative recommendation concerning the request for relief and the reasons for the tentative recommendation. No commitment will be made as to the conclusion that the Service will finally adopt.

.06 An invitation to an additional conference will be extended if after the conference of right an adverse holding is proposed but on a new issue or on the same issue but on different grounds from those discussed at the first conference. There is no right to another conference when a proposed holding is reversed at a higher level with a result less favorable to the taxpayer if the grounds or arguments on which the reversal is based were discussed at the conference of right. The provisions of this revenue procedure limiting the number of conferences a taxpayer is entitled to will not prevent a taxpayer from attending further conferences when, in the opinion of National Office personnel, such conferences are necessary. All additional conferences of the type discussed in this paragraph are held only at the invitation of the Service.

.07 It is the responsibility of the taxpayer to furnish in writing to the National Office any additional data, lines of reasoning, precedents, etc., that are proposed by the taxpayer and discussed at the conference but that were not previously or adequately presented in writing. The taxpayer must furnish the additional information within 21 calendar days. If the additional information is not received within that time, a ruling will be issued on the basis of the information on hand or, if appropriate, no ruling will be issued. Procedures for requesting an extension of the 21-day period and notifying the taxpayer or the taxpayer's representative of the Service's decision are the same as those stated in section 9.05.

SEC. 12. REFERRAL OF MATTERS TO THE NATIONAL OFFICE

.01 Requests for determination letters received by District Directors that, under the provisions of this revenue procedure, may not be acted upon by a district office, will be forwarded to the National Office for reply. The district office will let the taxpayer know that this action has been taken. District Directors also refer to the National Office any request for a determination letter that in their judgment should have the attention of the National Office.

.02 If the request involves an issue on which the Service will not issue a ruling or a determination letter, the request will not be forwarded to the National Office. The district office will let the taxpayer know that the Service will not issue a ruling or a determination letter on the issue. See section 8.01 of this revenue procedure.

SEC. 13. REFFERAL OF MATTERS TO DISTRICT OFFICERS

Requests for rulings received by the National Office that, under section 5 of this revenue procedure, may not be acted upon by the National Office will be forwarded to the district office that has examination jurisdiction over the taxpayer's return. The taxpayer will be notified of this action. If the request is on an issue or in an area of the type discussed in section 8.01 and it is decided not to issue a ruling, the National Office will let the taxpayer know and the request will then be forwarded to the appropriate district office for association with the related return.

SEC. 14. REVIEW OF DETERMINATION LETTERS

Determination letters issued under sections 7.01, 7.02, and 7.03 are not reviewed by the National Office before they are issued. If a taxpayer believes that a determination letter of this type is in error, the taxpayer may ask the District Director to reconsider the matter. The taxpayer may also ask the District Director to request technical advice from the National Office. In such an event the procedure in Rev. Proc. 82-38 must be followed.

SEC. 15. WITHDRAWAL OF REQUESTS

A request for a ruling or determination letter may be withdrawn at any time before the signing of the letter of reply. If a request for a ruling is withdrawn, the National Office may give its views on the subject matter of the request to the District Director whose office will have examination jurisdiction over the taxpayer's return for consideration in connection with any later examination of the taxpayer's return. Even though a request is withdrawn, all correspondence and exhibits will be kept by the Service and will not be returned to the taxpayer. In appropriate cases, the Service may publish its findings in a revenue ruling or revenue procedure.

SEC. 16. ORAL ADVICE TO TAXPAYERS

.01 The Service does not issue rulings or determination letters on oral requests. National Office officials and employees ordinarily do not discuss a substantive tax issue with a taxpayer before a written request for a ruling is received, since oral opinions or advice are not binding on the Service. This does not prevent a taxpayer from asking whether the Service will rule on a particular issue. In such cases, however, the name of the taxpayer and identifying number must be disclosed. The Service also will discuss questions relating to procedural matters about submitting a request for a ruling, including the application of the provisions of section 9 to a particular case.

.02 A taxpayer may seek oral technical assistance from a Taxpayer Service Representative in a district office or service center when preparing a return or report, under other established procedures. Oral advice is advisory only and the Service is not bound to recognize it in the examination of the taxpayer's return.

SEC. 17. EFFECT OF RULINGS

.01 A taxpayer may not rely on a ruling issued to another taxpayer. A ruling, except to the extent incorporated in a closing agreement, may be revoked or modified at any time under appropriate circumstances. See section 4.08 for the effect of a closing agreement. If a ruling is revoked or modified, the revocation or modification applies to all years open under the statutes, unless the Commissioner or the Commissioner's delegate exercises the discretionary authority under section 7805(b) of the Code to limit the retroactive effect of the revocation or modification. The manner in which this authority generally is exercised is given later in this section. For information on rulings relating to the sale or lease of articles subject to the manufacturer's excise tax and the retailer's excise tax, see section 17.08.

.02 When determining a taxpayer's liability, the District Director must ascertain whether (1) any ruling previously issued to the taxpayer has been properly applied, (2) the representations upon which the ruling was based reflected an accurate statement of the material facts, and (3) the transaction actually was carried out substantially as proposed. If, in the course of determining the tax liability, the District Director finds that a ruling should be modified or revoked, the findings and recommendations of the District Director will be forwarded to the National Office for consideration before further action. Such a referral to the National Office will be treated as a request for technical advice and the procedures of Rev. Proc. 82-38 will be followed. Otherwise the ruling is to be applied by the district office in its determination of the taxpayer's liability.

.03 Appropriate coordination with the National Office will be undertaken if any field official having jurisdiction over a return or other matter proposes to reach a conclusion contrary to a ruling previously issued to the taxpayer.

.04 A ruling found to be in error or not in accord with the current views of the Service may be modified or revoked. Modification or revocation of a ruling may be made by (1) a notice to the taxpayer to whom the ruling was issued, (2) an enactment of legislation or ratification of a tax treaty, (3) a decision of the United States Supreme Court, (4) the issuing of temporary or final regulations, or (5) the issuing of a revenue ruling, a revenue procedure, or other statement published in the Internal Revenue Bulletin. Consistent with these provisions, if a ruling relates to a continuing action or a series of actions, the ruling will ordinarily be applied until any one of the actions described above has taken place, or until specifically withdrawn.

.05 Except in rare or unusual circumstances, the revocation or modification of a ruling will not be applied retroactively to the taxpayer for whom the ruling was issued or to a taxpayer whose tax liability was directly involved in the ruling if (1) there has been no misstatement or omission of material facts, (2) the facts developed later are not materially different from the facts on which the ruling was based, (3) there has been no change in the applicable law, (4) the ruling was originally issued with respect to a prospective or proposed transaction, and (5) the taxpayer directly involved in the ruling acted in good faith in reliance upon the ruling and the retroactive revocation would be to the taxpayer's detriment. For example, the tax liability of each shareholder is directly involved in a ruling on the reorganization of a corporation. However, the tax liability of members of an industry is not directly involved in a ruling issued to one of the members, and the holding in a revocation or modification of a ruling to one member of an industry may be retroactively applied to other members of that industry. By the same reasoning, a tax practitioner may not obtain the nonretroactive application to one client of a modification or revocation of a ruling previously issued to another client. If a ruling is revoked by letter with retroactive effect, the letter will, except in fraud cases, state the grounds upon which the revocation is being made and the reasons why the revocation is being applied retroactively.

.06 A ruling issued on a particular transaction represents a holding of the Service on that transaction only. However, the application of that ruling to the transaction will not be affected by the later issuing of regulations (either temporary or final), if the conditions specified in section 17.05 are met. If the ruling is later found to be in error or no longer in accord with the position of the Service, it will not give the taxpayer protection for a like transaction in the same or later year.

.07 However, if a ruling is issued covering a continuing action or a series of actions and it is determined that the ruling was in error, or no longer in accord with the position of the Service, the Associate Chief Counsel (Technical) ordinarily will limit the retroactivity of the revocation or modification to a date that is not earlier than that on which the ruling is modified or revoked. To illustrate, if a taxpayer receives a ruling that certain payments are excludable from gross income for federal income tax purposes and it is later determined that the ruling is in error or no longer in accord with the position of the Service, the Associate Chief Counsel (Technical) ordinarily will restrict the retroactive application of a the revocation or modification of the ruling. If a taxpayer rendered service or provided a facility that is subject to the excise tax on services or facilities, and in reliance on a ruling issued to the same taxpayer did not pass the tax on to the user of the service or the facility, the Associate Chief Counsel (Technical) ordinarily will restrict the retroactive application of the revocation or modification of the ruling. If an employer incurred liability under the Federal Insurance Contributions Act, but in reliance on a ruling made to the same employer, neither collected the employee tax nor paid the employee and employer taxes under the Act, the Associate Chief Counsel (Technical) ordinarily will restrict the retroactive application of the revocation or modification of the ruling for both the employer tax and the employee tax. In the last situation, however, the restriction of retroactive application ordinarily will be conditioned on the furnishing by the er
ployer of wage data, as may be r
quired by section 31.6011(a)-1 of t
Employment Tax Regulations. Pub
cation of a notice of proposed ru
making will not affect the applicati
of any ruling issued under the proc
dures stated in this revenue procedur

.08 A ruling holding that the sale
lease of a particular article is subject
the manufacturer's excise tax or t
retailer's excise tax may not retroa
tively revoke or modify an earlier r
ing holding that the sale or lease
such an article was not taxable, if t
taxpayer to whom the ruling was
sued, in reliance upon the earlier r
ing, parted with possession or own
ship of the article without passing t
tax on to the customer. Section 11
(b), Revenue Act of 1926.

.09 For rulings involving complet
transactions, other than those d
scribed in sections 17.07 and 17.0
taxpayers will not be given the prote
tion against retroactive revocati
provided in section 17.05, since th
will not have entered into the transa
tions in reliance on the ruling.

SEC. 18. EFFECT OF DETERMINATION LETTERS

A determination letter issued by
District Director has the same effect
a ruling issued to a taxpayer under s
tion 17 of this revenue procedu
However, if the District Director is
the opinion that a conclusion contra
to that expressed in the determinati
letter is indicated, the matter need n
be referred to the National Office.
District Director may not limit t
modification or revocation of a det
mination letter but may refer the m
ter to the National Office for the pos
ble exercise by the Commissioner
the Commissioner's delegate of the a
thority to limit the modification
revocation.

SEC. 19. EFFECT OF INFORMATION LETTERS

An information letter issued by t
National Office or by a District Dir
tor is advisory only and the provisi
of section 17 do not apply.

SEC. 20. PROCEDURE FOR REQUESTING APPLICATION OF SECTION 7805(b) IN THE CASE O

RULINGS AND DETERMINATION LETTERS

.01 Pursuant to section 7805(b) of the Code, it is within the discretion of the Commissioner or the Commissioner's delegate to prescribe the extent, if any, to which any ruling (including determination letters) will be applied without retroactive effect.

A taxpayer to whom a ruling or determination letter has been issued may request that the Associate Chief Counsel (Technical), the Commissioner's delegate, exercise the discretionary authority under section 7805(b) of the Code to limit the retroactive effect of any subsequent revocation or modification of the ruling or determination letter.

.02 In the case of a ruling, a request to limit the retroactive effect of the revocation or modification of a ruling must be in the form of, and meet the requirements for, a ruling request generally. These requirements are set forth in section 9 of this revenue procedure. Specifically, the request must state that it is being made pursuant to section 7805(b), contain a statement of the relief sought and an explanation of the reasons and arguments in support of the relief requested, and also be accompanied by any documents bearing on the request. The explanation in support of the application of section 7805(b) should include a discussion of the five items enumerated in section 17.05 of this revenue procedure as they relate to the taxpayer's particular situation.

A request for the application of section 7805(b) of the Code may take the form of a separate request for ruling when, for example, a revenue ruling has the effect of modifying or revoking a ruling previously issued to the taxpayer or when the Service notifies the taxpayer of a change in position that will have the effect of revoking or modifying such a ruling. However, when such notice is given by the District Director during the course of an examination of the taxpayer's return, or during consideration by the Chief, Appeals Office, a request to limit the retroactive effect of the modification or revocation of a ruling must be made in the form of a request for technical advice. See section 12.03 of Rev. Proc. 82-38. When germane to a pending ruling request, a request for the application of section 7805(b) may be made as part of the request, either initially or at any time before the ruling is issued. When a ruling that concerns a continuing transaction is modified or revoked by, for example, a subsequent revenue ruling, a request to limit the retroactive effect of the modification or revocation of the ruling must be made before a return is examined that contains the transaction that is the subject of the request for ruling.

.03 When a request for the application of section 7805(b) of the Code is made in a separate ruling request, the taxpayer has the right to a conference in the National Office in accordance with the provisions of section 11 of this revenue procedure. If the request is made initially as part of a pending ruling request or is made before the conference of right is held on the substantive issues, the section 7805(b) issue will be discussed at the taxpayer's one conference of right. (See section 11.05 of this revenue procedure.) If the request for the application of 7805(b) is made as part of a pending ruling request after a conference has been held on the substantive issue, and the Service determines that there is justification for having delayed the request, then the taxpayer will have the right to one conference of right concerning the application of section 7805(b) with the conference limited to discussion of this issue.

.04 In the case of a determination letter that the District Director proposes to modify or revoke, a request to limit the modification or revocation of the determination letter must be made by requesting the District Director who issued the determination letter to seek technical advice from the National Office, since a District Director has not been delegated authority under section 7805(b) of the Code to limit the modification or revocation of a determination letter. See section 12.03 of Rev. Proc. 82-38. The taxpayer's request must state that it is being made pursuant to section 7805(b), contain a statement of the relief sought and an explanation of the reasons and arguments in support of the relief requested, and also be accompanied by any documents bearing on the request. The explanation in support of the application of section 7805(b) should include a discussion of the five items enumerated in section 17.05 of this revenue procedure as they relate to the taxpayer's particular situation.

.05 When technical advice is requested with respect to the application of section 7805(b) of the Code under the circumstances set forth in .04 above, the taxpayer has a right to a conference in the National Office to the same extent as does any taxpayer who is the subject of a technical advice request. See section 8 of Rev. Proc. 82-38.

SEC. 21. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 80-20 is superseded and Rev. Proc. 81-33 is superseded in part.

---

26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.

Rev. Proc. 82-38

SECTION 1. PURPOSE

The purpose of this revenue procedure is to update Rev. Proc. 80-21, 1980-1 C.B. 646, which provides revised procedures for furnishing technical advice to District Directors and Chiefs, Appeals Offices, by the Associate Chief Counsel (Technical). It also tells taxpayers about their rights when a District Director or a Chief, Appeals Office, requests such advice.

SEC. 2. SCOPE

.01 The Chief Counsel through the Associate Chief Counsel (Technical) provides principles and rules for uniformly interpreting and applying the federal tax laws under the jurisdiction of the Associate Chief Counsel (Technical). The procedures for obtaining technical advice specifically applicable to federal firearms taxes under subtitle E of the Internal Revenue Code are under the jurisdiction of the Bureau of Alcohol, Tobacco and Firearms. The procedures for obtaining technical advice specifically on employee plans and exempt organizations are under the jurisdiction of the Assistant Commissioner (Employee Plans and Exempt Organizations). The procedures that apply to technical advice for employee plans and exempt organizations are followed in obtaining technical advice on exemption of farmers' cooperatives from tax under section 521 of the Code, even though the Associate Chief Counsel (Technical) has jurisdiction for issuing technical advice under this section. The Associate Chief Counsel (Technical) also has jurisdiction for issuing technical advice under section 526, on shipowners' protection and indemnity associations; section 527(a), (b), (c), (d), (e), and (g), on political organizations; and section 528, on certain homeowners' associations, under this revenue procedure.

.02 In the Office of the Associate Chief Counsel (Technical), the authority to issue technical advice has been largely redelegated to the Branch Chiefs in the Individual Tax Division and the Corporation Tax Division.

SEC. 3. CHANGES

.01 Changes have been made to reflect the reorganization of the Internal Revenue Service.

.02 The applicable provisions of Rev. Proc. 81-33, 1981-2 C.B. 564, have been incorporated into this revenue procedure.

SEC. 4. DEFINITION AND NATURE OF TECHNICAL ADVICE

.01 For purposes of this revenue procedure, the word "taxpayer" includes all persons subject to any provision of the Internal Revenue Code and their representatives and issuers of section 103 obligations.

.02 Unless otherwise indicated, any reference to the National Office means only the Office of the Associate Chief Counsel (Technical).

.03 Any reference to District Director or district office includes the office of the Director of the Foreign Operations District, where appropriate. Any reference to Chief, Appeals Office, includes Associate Chief, Appeals Office.

.04 "Technical advice" means advice or guidance furnished by the National Office upon request of a district or an Appeals Office in response to any technical or procedural question that develops during any stage of any proceeding on the interpretation and proper application of tax law, tax treaties, regulations, revenue rulings, or other precedents published by the National Office to a specific set of facts. Such proceedings include (1) the examination of a taxpayer's return, (2) consideration of a taxpayer's claim for refund or credit, or (3) any other matter involving a specific taxpayer under the jurisdiction of the Chief, Examination Division, such as the consideration of a taxpayer's application to enter into an agreement about the useful life, method, and rate of depreciation of business property provided by section 167(d) of the Code. These proceedings include an examination to determine whether obligations issued are described in section 103(a). They also include processing and considering nondocketed cases in an Appeals Office. Technical advice is furnished as a way of helping Service personnel close cases and establish and maintain consistent holdings throughout the Internal Revenue Service. A District Director or an Appeals Office may raise an issue in any tax period, even though technical advice may have been asked for and furnished for the same or a similar issue for another tax period. Technical advice does not include memoranda on matters of general technical application furnished to district or Appeals Offices when the issues are not raised in connection with a proceeding involving a specific taxpayer.

.05 If a District Director, Chief, Appeals Office, or a taxpayer requests technical advice on a determination letter under section 521 of the Code, the procedures under section 601.201 (n) of the Statement of Procedural Rules must be followed.

.06 Only the National Office can revoke a ruling letter. Therefore, if a District Director or a Chief, Appeals Office, thinks that a ruling letter previously issued to a taxpayer should be modified or revoked, the procedures in section 5 of this revenue procedure must be followed.

.07 The provisions of this revenue procedure apply only to a case under the jurisdiction of a District Director or Chief, Appeals Office. Technical advice may be requested on issues considered in a prior Appeals disposition, not based on mutual concessions for the same tax period of the same taxpayer, if the Appeals Office that had the case concurs in the request. A District Director may not request tec nical advice on an issue if an Appea Office is currently considering identical issue of the same taxpayer (of a related taxpayer within the mea ing of section 267 of the Code or member of an affiliated group which the taxpayer is also a memb within the meaning of section 1504). case remains under the jurisdiction the District Director even though Appeals Office has the identical Iss under consideration in the case another taxpayer (not related with the meaning of sections 267 and 150 respectively) in an entirely differe transaction. With respect to the sa taxpayer or the same transactic when the issue is under the jurisdicti of an Appeals Office, and the applic bility of more than one kind of tax dependent upon the resolution of th issue, a District Director may not quest technical advice on the app cability of any of the taxes involved.

SEC. 5. REQUESTING TECHNICAL ADVICE

.01 The district or Appeals Offic responsible for determining whether request technical advice on any is being considered. However, while case is under the jurisdiction of District Director or the Chief, Appe Office, a taxpayer may request that issue be referred to the National Off for technical advice. The grounds a request are that a lack of uniform exists on the disposition of the issue that the issue is unusual or comp enough to warrant consideration the National Office. Although taxp ers are encouraged to make written quests setting forth the facts, law, a argument on the issue, and reasons requesting National Office techni advice, they may make the request ally. If, after considering the t payer's request, the examining offi or Appeals Officer thinks that the cumstances do not warrant referral the case to the National Office, examining officer or Appeals Offi will tell the taxpayer. (See section 6 taxpayer's appeal rights when examining officer or an Appeals ficer declines to request technical vice.)

.02 When technical advice is g to be requested, whether or not on request of the taxpayer, the taxpayer will be told about it, except as noted in section 5.10. If the examining officer or the Appeals Officer initiates the action, the Service will give the taxpayer a copy of the statement of the pertinent facts and the questions proposed for submission to the National Office. The request for advice should be worded to avoid possible misunderstanding in the National Office of the facts or the specific points at issue.

.03 If the Service initiates the request for technical advice, the taxpayer has 10 calendar days after receiving the statement of facts and specific questions to indicate in writing any disagreement about them. The taxpayer must justify in writing an extension of time beyond the 10 calendar days. The justification must be approved by the Chief, Examination Division, or the Chief, Appeals Office. Every effort should be made to reach agreement on the facts and the specific points at issue. If agreement cannot be reached, the taxpayer may send, within 10 calendar days after receipt of notice, a statement of the taxpayer's understanding of the specific points at issue. This statement will be forwarded to the National Office with the request for technical advice. The taxpayer must justify in writing an extension of time beyond the 10 calendar days. The justification must be approved by the Chief, Examination Division, or the Chief, Appeals Office.

.04 If the taxpayer initiates the action to request technical advice and the taxpayer's statement of the facts and points at issue is not wholly acceptable to the district or Appeals Office, the Service will tell the taxpayer in writing what the areas of disagreement are. The taxpayer has 10 calendar days after receiving the written notice to reply to it. The taxpayer must justify in writing an extension of time beyond the 10 calendar days. The justification must be approved by the Chief, Examination Division or the Chief, Appeals Office. If agreement cannot be reached, both the statements of the taxpayer and the district or Appeals Office will be forwarded to the National Office with the request for technical advice.

.05 If it has not already been done, the taxpayer may submit a statement explaining the taxpayer's position on the issues and citing precedents that the taxpayer believes will bear on the case. This statement will be forwarded to the National Office with the request for technical advice. If the taxpayer's statement is received after the request for technical advice has been forwarded to the National Office, it will be forwarded there to be associated with the request for technical advice. The taxpayer is encouraged to comment on any legislation, tax treaties, regulations, revenue rulings, revenue procedures, or court decisions contrary to the taxpayer's position.

.06 At the time the taxpayer is told that the matter is being referred to the National Office, the taxpayer will also be told about the right to a conference in the National Office if an adverse decision is indicated and will be asked to say whether such a conference is desired.

.07 In connection with requests for technical advice, the taxpayer also has the same 10 days as in sections 5.03 and 5.04 to submit the statement described in section 5.09 of proposed deletions under section 6110(c) of the Code. If the taxpayer does not submit it, the District Director or the Chief, Appeals Office, will tell the taxpayer that such a statement is required. If the District Director or the Chief, Appeals Office, does not receive the statement within 10 days after such notification, the District Director or the Chief, Appeals Office, may decline to submit the request for technical advice. If the District Director or the Chief, Appeals Office, decides to request technical advice in a case in which the taxpayer has not submitted the statement of proposed deletions, the National Office will make those deletions that the Commissioner determines are required by section 6110(c).

.08 The requirements for submitting statements and other material for proposed deletions in technical advice memoranda before public inspection is allowed do not apply to requests made by a District Director before November 1, 1976, or to requests for any document to which section 6104 of the Code applies.

.09 To help the National Office make the deletions required by section 6110(c) of the Code in technical advice memoranda to be made open to public inspection under section 6110(a), a deletions statement must accompany requests. The statement must either state that no information other than names, addresses, and identifying numbers need be deleted, or if more information is proposed to be deleted, the statement must indicate the deletions proposed by the taxpayer. If the latter alternative is chosen, the statement must be made in a separate document, and it must be accompanied by a copy of all statements of facts and supporting documents that are submitted to the National Office under sections 5.03 and 5.04. The material that the taxpayer wants deleted must be shown in brackets. The statement of proposed deletions must show the statutory basis, under section 6110(c), for each proposed deletion. The statement of proposed deletions must not appear or be referred to anywhere in the request for technical advice. If the taxpayer decides to request additional deletions under section 6110(c) before the National Office replies to the request for technical advice, the taxpayer may submit additional statements. The procedures in this paragraph also apply to additional information submitted during consideration of the technical advice request.

.10 The provisions of this section (about referring issues upon the taxpayer's request, telling the taxpayer about the referral of issues, submitting proposed deletions, and granting conferences in the National Office) do not apply to technical advice memoranda, described in section 6110(g)(5)(A) of the Code, on cases involving criminal or civil fraud investigations and jeopardy or termination assessments. However, in these cases the taxpayer may provide the statement of proposed deletions to the National Office after all proceedings in the investigations or assessments are complete but before the Commissioner mails the notice, under section 6110(f)(1), of intention to disclose the technical advice memorandum.

.11 See Rev. Proc. 79-63, 1979-2 C.B. 578, which concerns applications for extension of the time for making an election or application for relief pursuant to section 1.9100-1 of the regulations. If a taxpayer requests an extension of time under section 1.9100-1 during an examination or when being considered by an Appeals Office, the procedures of Rev. Proc. 82-38 are applicable.

.12 Form 4463, Request for Technical Advice, should be used for transmitting requests for technical advice to the National Office.

SEC. 6. APPEAL BY TAXPAYERS OF DISTRICT OR APPEALS OFFICE DETERMINATION NOT TO SEEK TECHNICAL ADVICE

.01 If the examining officer, or Appeals Officer thinks that a taxpayer's request for referral of an issue to the National Office for technical advice does not warrant referral, the examining officer or Appeals Officer will tell the taxpayer.

.02 The taxpayer may appeal the decision of the examining officer or the Appeals Officer not to request technical advice by submitting to that official, within 10 calendar days after being told of the decision, a statement of the facts, law, and arguments on the issue, and the reasons why the taxpayer believes the matter should be referred to the National Office for technical advice. The taxpayer must justify in writing a request for an extension of time beyond the 10 calendar days. The justification must be approved by the Chief, Examination Division, or the Chief, Appeals Office.

.03 The examining officer or the Appeals Officer submits the taxpayer's statement through channels to the Chief, Examination Division, or the Chief, Appeals Office, along with the examining officer's or the Appeals Officer's statement of why the issue should not be referred to the National Office. The Chief determines, on the basis of the statement, whether technical advice will be requested. If the Chief determines that technical advice is not warranted and proposes to deny the request, the taxpayer is told in writing about the determination. In the letter to the taxpayer, the Chief states the reasons for the proposed denial (except in unusual situations when doing so would be prejudicial to the best interest of the Government). The taxpayer has 10 calendar days after receiving the letter to notify the Chief of agreement or disagreement with the proposed denial. The taxpayer may not appeal the decision of the Chief, Examination Division, or the Chief, Appeals Office, not to request technical advice from the National Office. However, if the taxpayer does not agree with the proposed denial, all data on the issue for which technical advice has been sought, including the taxpayer's written request and statements, will be submitted to the Assistant Commissioner (Examination) or the Director, Appeals Division, for review. If the Assistant Commissioner (Examination) or the Director, Appeals Division, thinks the circumstances warrant it, he or she may consult the Associate Chief Counsel (Technical) or his or her representatives. After this review the district office or the Appeals Office is notified whether the proposed denial is approved or disapproved.

.04 While the matter is being reviewed, the district office or the Appeals Office suspends action on the issue (except when the delay would prejudice the Government's interests) until it is notified that the proposed denial is approved or disapproved. This notification is made within 30 calendar days after receipt of the data. The review is solely on the basis of the written record and no conference is held on the matter.

SEC. 7. WITHDRAWAL OF REQUESTS

.01 The District Director or Chief, Appeals Office, may withdraw a request for technical advice at any time before the responding transmittal memorandum is signed. The District Director or Chief, Appeals Office, must notify the taxpayer in writing of intent to withdraw the request for technical advice except (1) when the period of limitation on assessment is about to expire and the taxpayer has declined to sign a consent to extend the period, or (2) when such notification would be prejudicial to the best interests of the government. If the taxpayer does not agree that the request for technical advice should be withdrawn, the procedures in section 6 of this revenue procedure must be followed.

.02 When a request for technical advice is withdrawn, the National Office may send its views to the District Director or the Chief, Appeals Office, when acknowledging the withdrawal request. In appropriate cases, the subject matter may be published as a revenue ruling as revenue procedure.

SEC. 8. CONFERENCE IN THE NATIONAL OFFICE

.01 If after an analysis of the technical advice request it appears that advice adverse to the taxpayer will be given, and if a conference has been requested, the taxpayer will be told, by telephone if possible, the time and place of the conference. The conference must be held within 21 calendar days after such contact has been made. If conferences are being arranged for more than one request for technical advice for the same taxpayer, they will be scheduled to cause the least inconvenience to the taxpayer. An extension of the 21-day period will be granted only if the taxpayer justifies it in writing and the Chief or Assistant Chief of the technical branch to which the case is assigned approves it. Because the purpose of these procedures is to facilitate the technical advice process by encouraging prompt submission of the required relevant material, requests for extensions should be justified by compelling facts and circumstances. The request for extension should be submitted before the end of the 21-day period. If unusual circumstances near the end of the 21-day period make a written request impractical, within the 21-day period the National Office should be told orally about the problem and of the forthcoming written request for extension. These requests must be promptly submitted. The taxpayer or taxpayer's representative will be told promptly and later in writing of the approval or denial of the requested extension. There is no right of appeal to the denial of an extension request. If it is not advised of problems with meeting the 21-day period, or if the request is not sent promptly after the National Office is notified of problems with meeting the 21-day period, the Service will process the case on the assumption that no further submission will be received.

.02 A taxpayer is entitled by right

to only one conference in the National Office unless one of the circumstances discussed in this section exists. This conference is normally held at the branch level in the appropriate division (Individual Tax Division or Corporation Tax Division) of the office of the Associate Chief Counsel (Technical). It is attended by a person who has authority to sign the transmittal memorandum discussed in section 9.07 on behalf of the branch chief. When more than one branch has taken an adverse position on an issue within its jurisdiction presented in a request for technical advice, or when the position ultimately adopted by one branch will affect another branch's determination, a representative from each branch with authority to sign for the branch chief will attend the conference. In appropriate cases, the examining officer or the Appeals Officer may also attend the conference to clarify the facts in the case. If more than one subject is discussed at the conference, the discussion constitutes a conference for each subject. To promote a free and open discussion of the issues, the conference usually is held after the branch has had an opportunity to study the case. However, the taxpayer may request that the conference of right be held at a stage earlier in the consideration of the case than the Service would ordinarily designate. The taxpayer has no right to appeal the action of a branch to a division director or to any other official of the Service.

.03 Because conference procedures are informal, no tape, stenographic, or other verbatim recording of a conference is made.

.04 The senior Service representative at the conference ensures that the taxpayer has full opportunity to present views on all of the issues in question. The Service representatives explain the Service's tentative decision on the substantive issues and the reasons for it. If prospective application under section 7805(b) of the Code is advanced by the taxpayer, the Service representative will discuss the tentative recommendation concerning the request for relief and the reason for the tentative recommendation. No commitment will be made as to the conclusion that the Service will finally adopt.

.05 An invitation to an additional conference is made if, after the conference of right, an adverse holding is proposed either (1) on a new issue or (2) on the same issue but on grounds different from those discussed at the first conference. When a proposed holding is reversed at a higher level with a result less favorable to the taxpayer, the taxpayer has no right to another conference if the grounds or arguments on which the reversal is based were discussed at the conference of right. The limitation on the number of conferences to which a taxpayer is entitled does not prevent inviting a taxpayer to attend further conferences when National Office personnel think they are necessary. These additional conferences are held only at the invitation of the National Office.

.06 The taxpayer is responsible for furnishing in writing to the National Office within 21 calendar days after the conference any additional data, line of reasoning, precedents, etc., that the taxpayer proposed and that were discussed at the conference but not previously or adequately presented in writing. An extension of the 21-day period may be granted only if the taxpayer justifies it in writing and the Chief or the Assistant Chief of the Technical branch to which the case is assigned approves it. Procedures for requesting an extension of the 21-day period and notifying the taxpayer or the taxpayer's representative of the Service's decision are the same as those in section 8.01. Any additional material should be submitted in duplicate to the National Office. If the additional information would have a significant impact on the facts in the request for technical advice, the National Office sends a copy to the District Director or the Chief, Appeals Office, for comment on the facts contained in the additional information submitted. The District Director or the Chief, Appeals Office, gives the matter prompt attention.

.07 A taxpayer may get information on the status of the request for technical advice by contacting the district or Appeals Office that requested the technical advice.

.08 A District Director or a Chief, Appeals Office, may get current information on the status of the request for technical advice by calling the person whose name and telephone number are shown on the acknowledgement of receipt of the request for technical advice.

SEC. 9. PREPARATION OF TECHNICAL ADVICE MEMORANDUM BY THE NATIONAL OFFICE

.01 As soon as the request for technical advice is assigned, the technical employee analyzes the file to see whether it meets all requirements of section 5. If it does not comply with the requirements of section 5.09 relating to the statement of proposed deletions, the National Office makes the deletions from the technical advice memorandum that the Commissioner determines are required by section 6110(c) of the Code.

.02 Usually, within 21 calendar days after the Branch Office receives the request for technical advice, a representative of the Branch telephones the district or Appeals Office to discuss the procedural and substantive issues in the request that come within the Branch's jurisdiction. The Branch representative informs the district or Appeals Office:

(a) that the case is being returned because substantial additional information is required to resolve an issue, because significant unresolved factual variances exist between the statements of facts submitted by the district or Appeals Office and the taxpayer, or because major procedural problems cannot be resolved by phone; or

(b) that the case is not being returned but more information is needed or minor procedural deficiencies exist; or

(c) what the Branch representative's tentative conclusion is and the estimated date that the technical advice memorandum will be mailed; or

(d) that a tentative conclusion has not been reached because of the complexity of the issue and the estimated date the tentative conclusion will be made.

.03 Within 21 calendar days after the Branch receives the additional information requested in section 9.02(b), the Branch representative telephones the district or Appeals Office to discuss the procedural and substantive issues in the request that come within the jurisdiction of the Branch. The representative indicates either (1) the tentative conclusion and the estimated date the technical advice memorandum will be mailed, or (2) the fact that a tentative conclusion has not been reached because of the complexity of the issue and the estimated date the tentative conclusion will be made.

.04 Because the Branch representative's tentative conclusion may change during the preparation and review of the technical advice memorandum, it is not, under any circumstances, considered final. The district or Appeals Office may not tell the taxpayer what the tentative conclusion is.

.05 When the technical advice request concerns matters within the jurisdiction of more than one Branch or more than one office in the same Branch, a representative of the Branch that received the original technical advice request informs the district or Appeals Office within the initial 21 calendar day period; (1) that the matters within the jurisdiction of another Branch or another office in the same Branch have been referred to the other Branch or office for consideration, and (2) that a representative of the other Branch or office will contact the district or Appeals Office about the referral of the technical advice request within 21 calendar days after receiving it in accordance with section 9.02.

.06 Generally, before replying to the request for technical advice, the National Office informs the taxpayer orally or in writing of the material likely to appear in the technical advice memorandum which the taxpayer proposed be deleted but which the Service determined should not be deleted. If so informed, the taxpayer may submit within 10 calendar days any further information, arguments, or other material should be deleted. The Service attempts, if possible, to resolve all disagreements about proposed deletions before the National Office replies to the request for technical advice. However, the taxpayer does not have the right to a conference to resolve any disagreements about material to be deleted from the text of the technical advice memorandum. These matters, however, may be considered at any conference otherwise scheduled for the request.

.07 Replies to requests for technical advice are addressed to the District Director or the Chief, Appeals Office, and are in two parts. Each part identifies the taxpayer by name, address, identification number, and year or years involved. The first part of the reply is a transmittal memorandum. In unusual cases it is a way of giving the district or Appeals office administrative information or other information that under the nondisclosure statutes or for other reasons, may not be discussed with the taxpayer. The second part (the "technical advice memorandum") contains (1) a statement of the issues; (2) a statement of the pertinent facts in the issues; (3) a statement of the pertinent law, tax treaties regulations, revenue rulings and other precedents published in the Bulletin, and court decisions; (4) a discussion of the rationale developed by the National Office; and (5) the conclusions of the National Office. The conclusions give direct answers, whenever possible, to the specific questions of the district or Appeals office. The discussion of the issues is in enough detail so the district or Appeals officials know the reasoning underlying the conclusion. Accompanying the technical advice memorandum is a notice, under section 6110(f)(1) of the Code, of intention to disclose a technical advice memorandum (including a copy of the version proposed to be open to public inspection and notations of third party communications under section 6110(d)). The District Director or the Chief, Appeals Office, forwards this notice to the taxpayer when the District Director or the Chief, Appeals Office, gives a copy of the technical advice memorandum to the taxpayer according to section 9.08.

.08 The general practice of the Service is to give a copy of the technical advice memorandum to the taxpayer after it has been adopted by the District Director or the Chief, Appeals Office. However, in the case of technical advice memoranda described in section 6110(g)(5)(A) of the Code, relating to cases involving criminal or civil fraud investigations and jeopardy or termination assessments, a copy of the technical advice memorandum is not given to the taxpayer until all proceedings in the investigations or assessments are completed.

.09 If after receiving the notice under section 6110(f)(1) of the Code of intention to disclose the technical advice memorandum the taxpayer wants to protect the disclosure of certain information in it, the taxpayer must submit a written statement within 20 calendar days identifying those deletions not made by the Service that the taxpayer believes should have been made. The taxpayer must also submit a copy of the version of the technical advice memorandum proposed to be open to public inspection with brackets around deletions that are proposed by the taxpayer but that have not been made by the National Office. Generally, the National Office does not consider the deletion of any material that the taxpayer has not proposed be deleted before the National Office sent its reply to the request for technical advice to the District Director or the Chief, Appeals Office. Within 20 calendar days after it receives the taxpayer's response to the notice under section 6110(f)(1), the National Office must mail the taxpayers its final administrative conclusion about the deletions to be made.

SEC. 10. ACTION ON TECHNICAL ADVICE IN DISTRICT AND APPEALS OFFICES

.01 The District Director or the Chief, Appeals Office, processes the taxpayer's case on the basis of the conclusions in the technical advice memorandum unless (1) the District Director or the Chief, Appeals Office, thinks that the conclusions reached by the National Office in a technical advice memorandum should be reconsidered, or (2) the Chief, Appeals Office, in the case of technical advice unfavorable to the taxpayer, decides to settle the issue in the usual manner under existing authority.

.02 The District Director or the Chief, Appeals Office, gives the taxpayer (1) a copy of the technical advice memorandum described in section 9.07, and (2) the notice under section 6110(f)(1) of the Code of intention to disclose the technical advice memorandum (including a copy of the version proposed to be open to public inspection and notations of third party communications under section 6110(d)). This requirement does not apply to technical advice memoranda involving civil fraud or criminal investigations; jeopardy or termination assessments, as described in section 5.10; or documents to which section 6104 applies.

.03 In those cases in which the National Office tells the District Director or the Chief, Appeals Office, that a copy of the technical advice memorandum should not be given to the taxpayer, the District Director or the Chief, Appeals Office, tells this to the taxpayer if the taxpayer requests a copy.

SEC. 11. EFFECT OF TECHNICAL ADVICE

.01 Except in rare or unusual circumstances, a holding in a technical advice memorandum that is favorable to the taxpayer is applied retroactively. Moreover, since technical advice, as described in section 4.04 of this revenue procedure, is issued only on closed transactions, a holding that is adverse to the taxpayer is also applied retroactively unless the Associate Chief Counsel (Technical) exercises the discretionary authority under section 7805(b) of the Code to limit the retroactive effect of the holding.

.02 A holding that modifies or revokes a holding in a prior technical advice memorandum is applied retroactively, with one exception. If the new holding is less favorable to the taxpayer than the earlier one, it generally is not applied to the period in which the taxpayer relied on the prior holding in situations involving continuing transactions.

.03 If a technical advice memorandum relates to a continuing action or a series of actions, it is ordinarily applied until specifically withdrawn or until the conclusion is modified or revoked by enactment of legislation, ratification of a tax treaty, or issuance of a United States Supreme Court decision, regulations (temporary or final), a revenue ruling, or other statement published in the Internal Revenue Bulletin. Publication of a notice of proposed rulemaking does not affect the application of a technical advice memorandum.

.04 Generally, a technical advice memorandum that revokes or modifies a letter ruling or another technical advice memorandum is not applied retroactively for either the taxpayer to whom or for whom the ruling or memorandum was originally issued or for a taxpayer whose tax liability was directly involved in such ruling or memorandum if: (1) there has been no misstatement or omission of material facts; (2) the facts later developed are not materially different from the facts on which the ruling or memorandum was based; (3) there has been no change in the applicable law; (4) the ruling was originally issued for a prospective or proposed transaction; and (5) the taxpayer directly involved in the ruling or memorandum acted in good faith in relying on the ruling or memorandum and the retroactive revocation would be to the taxpayer's detriment. The tax liabilities of members of an industry are not directly involved in a ruling or in a memorandum issued to or for one of the members. The holding in a revocation or modification of a ruling or a memorandum to or for one member of an industry may be retroactively applied to other members of that industry. A tax practitioner may not obtain the nonretroactive application for one client of a modification or revocation of a ruling or a memorandum that was previously issued to or for another client. When a ruling to a taxpayer or a memorandum involving a taxpayer is revoked with retroactive effect, the notice to the taxpayer, except in fraud cases, sets forth the grounds on which the revocation is being made and the reasons why the revocation is being applied retroactively.

SEC. 12. PROCEDURES FOR REQUESTING APPLICATION OF SECTION 7805(b) IN THE CASE OF TECHNICAL ADVICE

.01 Pursuant to section 7805(b) of the Code, it is within the discretion of the Commissioner or the Commissioner's delegate to prescribe the extent, if any, to which any ruling (including technical advice) will be applied without retroactive effect.

A taxpayer to whom a technical advice memorandum has been addressed or with respect to whom a technical advice request is pending may request that the Associate Chief Counsel (Technical), the Commissioner's delegate, exercise the discretionary authority under section 7805(b) of the Code to limit the retroactive effect of any holding stated in the technical advice memorandum or to limit the retroactive effect of any subsequent modification or revocation of the technical advice memorandum.

.02 When a technical advice memorandum that concerns a continuing transaction is modified or revoked by, for example, a subsequent revenue ruling or final regulations, a request to limit the retroactive effect of the modification or revocation of the technical advice memorandum must be made in the form of a request for a ruling when the request is submitted before a return is examined that contains the transaction that is the subject of the request for ruling. See section 20.02 of Rev. Proc. 82-37, page 491, this Bulletin.

.03 When a taxpayer is informed of the modification or revocation of a technical advice memorandum, ruling letter, or determination letter during the course of an examination of the taxpayer's return by the District Director or during consideration by the Chief, Appeals Office, a request to limit the retroactive application of the modification or revocation of the technical advice memorandum, ruling letter, or determination letter must itself be made in the form of a request for technical advise. See section 5 of this revenue procedure. However, the taxpayer must also submit a statement, which will be forwarded to the National Office with the request for technical advice, that the request is being made pursuant to section 7805(b) of the Code. This statement must also set forth the relief sought and an explanation of the reasons and arguments in support of the relief requested, and it must be accompanied by any documents bearing on the request. The explanation in support of the application of section 7805(b) should include a discussion of the five items enumerated in section 11.04 of this revenue procedure as they relate to the taxpayer's particular situation.

.04 A request to limit the retroactive effect of a holding in a technical advice memorandum that does not modify or revoke a technical advice memorandum may be made as part of that technical advice request either initially or at any time before the technical advice memorandum is issued by the National Office. In such a case, the taxpayer must also submit a statement in support of the application of section 7805(b) of the Code, as described in .03 above.

.05 When a request for technical advice concerns only the application of section 7805(b) of the Code, the taxpayer has the right to a conference in the National Office in accordance with the provisions of section 8 of this revenue procedure. If the request for application of 7805(b) is included in the request for technical advice on the substantive issues or is made before the conference of right on the substantive issues, the section 7805(b) issue will be discussed at the taxpayer's one conference of right. If the request for the application of 7805(b) is made as part of a pending technical advice request after a conference has been held on the substantive issue, and the Service determines that there is justification for having delayed the request, then the taxpayer will have the right to one conference of right concerning the application of section 7805(b) with the conference limited to discussion of this issue.

SEC. 13. EFFECT ON OTHERS DOCUMENTS

Rev. Proc. 80-21 and Rev. Proc. 81-33 are superseded.

---

26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.

Whether a United States subsidiary whose taxable income has been increased for a tax year because of an allocation under section 482 of the Code may receive payment from its foreign parent corporation from which, or to which, the allocation of income or deductions was made, in an amount not in excess of the taxable income increase without further federal income tax consequences. See Rev. Rul. 82-80, page 89.

Treasury Department Order No. 150-95

Reorganization of Internal Revenue Service National Office, Assignment of Functions to Chief Counsel, Internal Revenue Service

By Virtue of the authority vested in me as Secretary of the Treasury, including the authority vested in me by Reorganization Plan No. 26 of 1950 and Reorganization Plan No. 1 of 1952, the Internal Revenue Service National Office is reorganized as specified in this Order. The offices and positions of Associate Commissioner (Operations), Associate Commissioner (Policy and Management), Associate Commissioner (Data Processing), and Assistant to the Commissioner (Congressional Affairs) are established in the Internal Revenue Service. The Associate Commissioners will report to the Commissioner through the Deputy Commissioner. The Deputy Commissioner will provide overall coordination and direction and will continue in the role of advising the Commissioner and providing line supervision to the Regional Commissioners.

1. *Office of the Associate Commissioner (Operations)*

The Associate Commissioner (Operations) is the principal advisor to the Commissioner on policy matters affecting operations.

The Associate Commissioner (Operations) is responsible for the following activities:

a. Serves as the spokesperson for the operating functions, which are: Collection of delinquent accounts and securing of delinquent returns; investigation of criminal fraud involving any internal revenue laws (except those concerning alcohol, tobacco, or firearms); examination of tax returns; approval and subsequent examination of Employee Plans and Exempt Organizations; and the Tax Information program.

b. Provides policy guidance and direction to the Assistant Commissioner (Collection), Assistant Commissioner (Examination), Assistant Commissioner (Criminal Investigation), and the Assistant Commissioner (EP/EO).

c. Represents the Service, as designated by the Commissioner, to the Department of the Treasury, Office of Management and Budget, Congress, and the public on major cross-functional issues and discusses or explains the Service's policy formulation and long-term plans.

Under the supervision of the Associate Commissioner (Operations) are the following organizations:

a. Office of the Assistant Commissioner (Collection)

b. Office of the Assistant Commissioner (Examination)

c. Office of the Assistant Commissioner (Criminal Investigation)

d. Office of the Assistant Commissioner (Employee Plans and Exempt Organizations)

2. *Office of Associate Commissioner (Policy and Management)*

The Associate Commissioner (Policy and Management) is the principal advisor to the Commissioner on policy matters affecting agency administration.

The Associate Commissioner (Policy and Management) is responsible for the following activities:

a. Serves as the spokesperson for the administrative functions, which are: Personnel administration; fiscal management; training and employee development; management information systems; advice and assistance to foreign governments on tax administration; management of the Service's physical plant, equipment, property, and support services; disclosure and security; tax forms and publication design, printing, and distribution; provision of centralized clerical, typing, and mass processing support in district offices for the operating functions; and operation of the IRS Data Center (payroll and non-tax data processing).

b. Provides policy guidance and direction to the Assistant Commissioner (Support and Services), the Assistant Commissioner (Human Resources), and the Assistant Commissioner (Planning, Finance, and Research).

c. Conducts the research, planning, analysis, and budget formulation functions of the Service.

d. Represents the Service, as designated by the Commissioner, to the Department of the Treasury, Office of Management and Budget, Congress, and the public on major issues, and discusses or explains the Service's policy formulation and long-term plans.

Under the supervision of the Associate Commissioner (Policy and Management) are the following organizations:

a. Office of the Assistant Commissioner (Support and Services)

b. Office of the Assistant Commissioner (Human Resources)

c. Office of the Assistant Commissioner (Planning, Finance, and Research)

3. *Office of Associate Commissioner (Data Processing)*

The Associate Commissioner (Data Processing) is the principal advisor to the Commissioner on policy matters affecting data processing.

The Associate Commissioner (Data Processing) is responsible for the following activities:

a. Serves as the spokesperson for the data processing functions, which are: Processing of tax returns and information documents, accounting for all revenues collected by the Service, maintaining master files of all taxpayer accounts, managing all large-scale tax-processing computers in the Service, and designing, developing, testing, and maintaining computer software used on large-scale tax-processing computers in the Service.

b. Provides policy guidance and direction to the Assistant Commissioner (Computer Services) and the Assistant Commissioner (Returns and Information Processing).

c. Represents the Service, as designated by the Commissioner, to the Department of the Treasury, Office of Management and Budget, Congress, and the public on major data processing issues, and discusses or explains the Service's policy formulation and long-term plans.

Under the supervision of the Associate Commissioner (Data Processing) are the following organizations:

a. Office of the Assistant Commissioner (Computer Services)

b. Office of the Assistant Commissioner (Returns and Information Processing)

4. *Office of Assistant to the Commissioner (Congressional Affairs)*

The Assistant to the Commissioner (Congressional Affairs) is the principal advisor to the Commissioner, Deputy Commissioner, and top executives of the Service on all Congressional and legislative matters except those involving appropriation hearings, and is responsible for planning, developing, directing, and evaluating the Congressional Affairs program and activities of the Service.

5. *The Assistant Commissioner (Inspection) and the Deputy Assistant Commissioner (Inspection)*

The Assistant Commissioner (Inspection) and the Deputy Assistant Commissioner (Inspection) will, to ensure objectivity and integrity, continue to report directly to the Commissioner and Deputy Commissioner.

6. The Corporation Tax, Individual Tax, and Appeals Divisions are transferred to the Chief Counsel, and the Commissioner of Internal Revenue will exercise line supervision over the Chief Counsel for these functions. The transfer of such personnel, records, equipment and funds will be determined by the Commissioner of Internal Revenue and Chief Counsel as appropriate.

7. The Office of the Commissioner shall consist of the Commissioner, Deputy Commissioner, Assistants to the Commissioner, Assistant to the Commissioner (Public Affairs), Assistant to the Commissioner (Congressional Affairs), Assistant to the Commissioner (Taxpayer Ombudsman), the Assistant to the Commissioner (Equal Opportunity), and the Assistant to the Deputy Commissioner.

8. The Commissioner of Internal Revenue may assign functions to component organizations in such manner as he may determine to be in the interest of efficiency and economy of operation.

9. This Order shall become effective upon such date as the Commissioner of Internal Revenue may determine. Prior Treasury Department Orders are hereby amended, supplemented, or superseded as is appropriate.

DONALD T. REGAN,
Secretary of the Treasury.

Dated: January 11, 1982.

(Filed by the Office of the Federal Register on January 22, 1982, 8:45 a.m., and published in the issue of the Federal Register for January 25, 1982, 47 F.R. 3464)

Treasury Department Order No. 150-96

Creation of the Foreign Operations Internal Revenue District

Dated: March 15, 1982.

Under the authority given to the President to establish Internal Revenue Districts by Section 7621 of the Internal Revenue Code, as amended, and vested in me as Secretary of the Treasury by Executive Order 10289, approved September 17, 1951, as made applicable to the Internal Revenue Code of 1954, and pursuant to the authority vested in me by Reorganization Plan No. 26 of 1950, and Reorganization Plan No. 1 of 1952 as made applicable to the Internal Revenue Code of 1954 by Section 7804(a) of such Code and Executive Order 10574, there is created the Foreign Operations Internal Revenue District that will replace the Office of International Operations, Internal Revenue Service.

1. All functions, personnel, materials, facilities, equipment and responsibilities of the Office of International Operations shall be transferred to the Foreign Operations District as of the effective date of its establishment.

2. *District Director of Internal Revenue.* The District Office shall bear the title "District Director of Internal Revenue" identified by the name Foreign Operations District with the Headquarters Office to be located in Washington, D.C.

3. This Order shall become effective upon such date as the Commissioner of Internal Revenue may determine. Prior inconsistent Treasury Department Orders are hereby amended, supplemented, or superseded.

R. TIMOTHY MCNAMAR,
Deputy Secretary of the Treasury.

Dated: March 15, 1982

(Filed by the Office of the Federal Register on March 26, 1982, 8:45 a.m., and published in the issue of the Federal Register for March 29, 1982, 47 F.R. 13267)

Notice of Proposed Rulemaking

CONTENTS

EE-11-78 **515**
EE-69-80 **516**
EE-153-81 **517**
LR-201-76 **519**
LR-74-77 **520**
LR-83-80 **522**
LR-176-80 **526**
LR-6-81 **530**
LR-75-81 **531**
LR-111-81 **557**
LR-120-81 **559**
LR-160-81 **560**
LR-161-81 **561**
LR-189-81 **565**
LR-192-81 **566**
LR-276-81 **567**
LR-311-81 **570**
LR-313-81 **572**
LR-4-82 **573**

The "Proposed regulations" heading in the Index contains a list of Code sections affected, the subject matter, and the "LR" or "EE" number and page.

Notice of Proposed Rulemaking

Early Termination of Qualified Plans

EE-11-78

SUMMARY: This document contains proposed regulations relating to the limitation of benefits in the event of the early termination of certain tax qualified retirement plans providing defined benefits for employees. Changes in the applicable law were made by the Employee Retirement Income Security Act of 1974 [Pub. L. 93-406, 1974-3 C.B. 1]. The regulations would provide the public with additional guidance needed to comply with that Act and would affect employers maintaining such plans and employees covered by such plans subject to Title IV of that Act.

DATES: Written comments and requests for a public hearing must be delivered or mailed by March 29, 1982. In general, the amendments are proposed to be effective for plan terminations occurring on or after March 29, 1982.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (EE-11-78), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Marjorie Hoffman of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3430) (not a toll-free number).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 401 of the Internal Revenue Code of 1954. The amendments reflect certain provisions of Title IV of the Employee Retirement Income Security Act of 1974 (88 Stat. 1003) [Pub. L. 93-406, 1974-3 C.B. 1, 172] related to plan termination insurance. These amendments are to be issued under the authority contained in sections 411(d)(2) and (3) and 7805 of the Internal Revenue Code of 1954 (68A Stat. 917, 88 Stat. 912; 26 U.S.C. 411(d)(2) and (3) and 7805). The proposed amendments contain references to certain vesting regulations (section 411 of the Code and Income Tax Regulations §1.411(d)-2 (26 CFR Part 1)).

STATUTORY PROVISIONS

Section 401(a)(4) of the Code prescribes certain discrimination standards which are qualification requirements for employee retirement plans (and related trusts) described in sections 401(a), 403(a), and 405 of the Code. Section 411(d)(2) and (d)(3) of the Code prescribe additional vesting-discrimination standards which are also qualification standards for these retirement plans.

SPECIFIC RULES CONCERNING PLAN PROVISIONS

Prior to the enactment of ERISA, a qualified plan could provide either for termination at will by the employer or discontinuance of contributions thereunder, and yet limit the likelihood that the plan would result in discrimination prohibited by section 401(a)(4) and (a)(7). The plan did this by satisfying certain conditions, including the incorporation of provisions which complied with the restrictions contained in paragraph (c)(2) of §1.401-4.

Because of various provisions added by ERISA, that regulation is proposed to be amended. In general, the amendment which is applicable to certain retirement plans covered by section 4021(a) of ERISA would raise the limit of employer contributions for the benefit of the 25 highest paid employees without violating the provisions of section 401(a)(4) of the Code. The additional employer contributions allowed as a result of this change will, as a result of the interaction of sections 401(a) and 411 of the Code, be mandatory. The increased amount available to substantial owners is equal to the present value of the benefit guaranteed for substantial owners under section 4022 of ERISA, or if the plan has not terminated, the present value of the benefit that would be guaranteed if the plan terminated on the date the benefit commenced. The increased amount available to employees other than substantial owners is equal to the present value of the benefit guaranteed under section 4022(b)(3)(B) of ERISA.

Under these regulations a plan would be required to apply the new dollar limits in order to continue to satisfy the vesting requirements of section 411. However, a plan amendment, incorporating the higher limits would not be required to be adopted until 1984, unless the plan were terminated prior to that time. It is anticipated that, if this regulation is adopted, the Service will provide further guidance regarding plan amendments to raise the "high 25" limits.

In this connection it should be noted that nonforfeitable benefits for purposes of Title IV of ERISA are determined under the definition of that term in Title IV and implementing Pension Benefit Guaranty Corporation regulations.

REGULATORY FLEXIBILITY ACT

Although this document is a notice of proposed rulemaking which solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably eight copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written

comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

DRAFTING INFORMATION

The principal authors of these proposed regulations were Richard J. Wickersham and Leonard S. Hirsh of the Employee Plans and Exempt Organizations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Proposed amendments to the regulations

The proposed amendments to 26 CFR Part 1 are as follows:

Section 1.401-4 is amended by adding three new sentences at the end of paragraph (c)(1) and by adding a new paragraph (c)(7). These added provisions read as follows:

§1.401-4 Discrimination as to contributions or benefits.

* * * * *

(c)(1) *** Any pension plan containing a provision described in this paragraph shall not fail to satisfy section 411(a), (d)(2) and (d)(3) merely by reason of such a plan provision. Paragraph (c)(7) sets forth special early termination rules applicable to certain qualified defined benefit plans for plan years affected by the Employee Retirement Income Security Act of 1974 ("ERISA") [Pub. L. 93-406, 1974-3 C.B. 1]. Paragraph (c)(7) does not contain all the rules required by the enactment of ERISA.

* * * * *

(7)(i) A qualified defined benefit plan subject to section 412 (without regard to section 412(h)(2)) shall not be required to contain the restriction described in paragraph (c)(2)(ii)(*c*) applicable to an employee in a plan whose full current costs for the first 10 years have not been funded.

(ii) A qualified defined benefit plan covered by section 4021(a) of ERISA ("qualified Title IV plan") shall satisfy the restrictions in paragraph (c)(2) of this section only if the plan satisfies this paragraph (c)(7). A plan satisfies this paragraph (c)(7) by providing that employer contributions which may be used for the benefit of an employee described in paragraph (c)(2) who is a substantial owner, as defined in section 4022(b)(5) of ERISA, shall not exceed the greater of the dollar amount described in paragraph (c)(2)(iii) or a dollar amount which equals the present value of the benefit guaranteed for such employee under section 4022 of ERISA, or if the plan has not terminated, the present value of the benefit that would be guaranteed if the plan terminated on the date the benefit commences, determined in accordance with regulations of the Pension Benefit Guaranty Corporation ("PBGC").

(iii) A plan satisfies this paragraph (c)(7) by providing that employer contributions which may be used for the benefit of all employees described in paragraph (c)(2) (other than an employee who is a substantial owner as defined in section 4022(b)(5) of ERISA) shall not exceed the greater of the dollar amount described in paragraph (c)(2)(iii) or a dollar amount which equals the present value of the maximum benefit described in section 4022(b)(3)(B) of ERISA (determined on the date the plan terminates or on the date benefits commence, whichever is earlier) without regard to any other limitations in section 4022 of ERISA.

(iv) A plan provision satisfying this paragraph (c)(7) may be adopted by amendment or by incorporation at the time of establishment. Any allocation of assets attributable to employer contributions to an employee which exceeds the dollar limitation in this paragraph (c)(7) may be reallocated to prevent prohibited discrimination.

(v) The early termination rules in the preceding subparagraphs (1) through (6) apply to a qualified Title IV plan except where such rules are determined by the Commissioner to be inconsistent with the rules of this paragraph (c)(7), §1.411(d)-2, and section 4044(b)(4) of ERISA. The early termination rules of this paragraph (c)(7) contain some of the rules under section 401(a)(4) and (a)(7), as in effect on September 2, 1974, and section 411(d)(2) and (3). Section 1.411(d)-2 also contains certain discrimination and vesting rules which are applicable to plan terminations.

(vi) Paragraph (c)(7) shall apply to a qualified Title IV plan which is considered terminated within the meaning of §1.411(d)-2(c)(2) on or after March 29, 1982.

ROSCOE L. EGGER, JR.,
Commissioner of
Internal Revenue.

(Filed by the Office of the Federal Register on January 25, 1982, 8:45 a.m., and published in the issue of the Federal Register for January 26, 1982, 47 F.R. 3562.)

Notice of Proposed Rulemaking

Minimum Investment Return of Private Foundations

EE-69-80

SUMMARY: This document contains proposed clarifying amendments to regulations relating to the excise tax imposed by section 4942 on the undistributed income of a private foundation. The existing regulations do not deal explicitly with future interests created by the private foundation. The proposed regulations will provide guidance to foundations that may be subject to this tax.

DATES: Written comments and requests for a public hearing must be delivered or mailed by March 29, 1982. The amendments are proposed to be effective for taxable years beginning after December 31, 1969.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T:EE-69-80, Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: George B. Baker of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T:EE-69-80, 202-566-3422 (not a toll-free call).

SUPPLEMENTARY INFORMATION

BACKGROUND

This document contains proposed amendments to the Foundation and

Similar Excise Taxes (26 CFR Part 53) under section 4942 of the Internal Revenue Code of 1954. The amendments are to be issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917, 26 U.S.C. 7805).

PROPOSED AMENDMENTS

In determining whether a private foundation has undistributed income for a taxable year, the private foundation's minimum investment return must be computed. This involves multiplying the fair market value of the assets of the foundation, excluding certain assets, by the applicable percentage. For this computation, the regulations provide that future interests are excluded from the foundation's assets until all intervening interests have expired. The amendment clarifies that the exclusion is not available to any future interest created by the private foundation after December 31, 1969. An additional amendment deletes a cross reference in section 53.4942(a)-3(d)(2) to section 1.9100-1 of the regulations. The cross reference is inappropriate because section 1.9100-1, by its terms, is not applicable to the private foundation excise taxes in Subtitle D of the Code.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before these proposed regulations are adopted, consideration will be given to any written comments that are submitted (preferably six copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

REGULATORY FLEXIBILITY ACT

Although this document is a notice of proposed rulemaking which solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

DRAFTING INFORMATION

The principal author of these proposed regulations was George B. Baker of the Employee Plans and Exempt Organizations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Proposed amendments to the regulations

Amendments to 26 CFR Part 53 are proposed as follows:

Paragraph 1. Subdivision (i) of section 53.4942(a)-2(c)(2) is revised to read as follows:

§53.4942(a)-2 Computation of undistributed income.

* * * * *

(c) *Minimum investment return.* ***

(2) *Certain assets excluded.* ***

(i) Any future interest (such as a vested or contingent remainder, whether legal or equitable) of a foundation in the income or corpus of any real or personal property, other than a future interest created by the private foundation, after December 31, 1969, until all intervening interests in, and rights to the actual possession or enjoyment of, such property have expired, or, although not actually reduced to the foundation's possession, until such future interest has been constructively received by the foundation, as where it has been credited to the foundation's account, set apart for the foundation, or otherwise made available so that the foundation may acquire it at any time or could have acquired it if notice of intention to acquire had been given;

* * * * *

Paragraph 2. The last sentence of subparagraph (2) of §53.4942(a)-3(d) is deleted.

ROSCOE L. EGGER, JR.,
Commissioner of
Internal Revenue.

(Filed by the Office of the Federal Register on January 25, 1982, 8:45 a.m., and published in the issue of the Federal Register for January 26, 1982, 47 F.R. 3558)

Notice of Proposed Rulemaking

Private Foundation Distributions

EE-153-81

SUMMARY: This document contains proposed regulations relating to private foundation distribution requirements. Changes to the applicable law were made by the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256]. The regulations would provide the public with the guidance needed to comply with that Act and would affect all private foundations.

DATES: Written comments and requests for a public hearing must be delivered or mailed by July 12, 1982. The amendments are proposed to be effective for taxable years beginning after December 31, 1981.

ADDRESS: Send comments and request for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T: EE-153-81, Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Monice Rosenbaum of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 Attention: CC:LR:T: EE-153-81, (202-566-3422) (not a toll-free number).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Regulations on Foundations and Similar Excise Taxes (26 CFR Part 53) under section 4942(d) and section 4942(j) (3)(A) of the Internal Revenue Code of 1954. These amendments are proposed to conform the regulations to section 823 of the Economic Recovery Tax Act of 1981 (Pub. L. 97-34, [1981-2 C.B. 256, 350] 95 Stat. 351) (ERTA). These regulations are to be issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

IN GENERAL

Section 4942(a) imposes an excise tax on private foundations that fail to distribute their income for charitable purposes. To avoid liability, a private foundation must make "qualifying distributions" each year equal to the foundation's "distributable amount". Certain foundations defined as "operating foundations" are not subject to this distribution requirement. For taxable years beginning after December 31, 1981, section 823 of ERTA amends the statutory definitions of the terms "distributable amount" and "operating foundation."

DISTRIBUTABLE AMOUNT

Under prior law, a foundation's distributable amount was equal to the greater of the foundation's adjusted net income or its minimum investment return (generally, 5% of the value of the foundation's investment assets). Under the amendment, a foundation's distributable amount is equal to its minimum investment return.

DEFINITION OF OPERATING FOUNDATION

For purposes of section 4942, an operating foundation is defined as any foundation which, among other requirements, makes qualifying distributions directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated.

Under prior law, an operating foundation was required to make qualifying distributions equal to substantially all of its adjusted net income. Under the amendment, an operating foundation is required to make qualifying distributions equal to substantially all of the lesser of the foundation's adjusted net income or its minimum investment return.

The amendment also provides that if a foundation makes qualifying distributions in excess of its minimum investment return but fails to distribute substantially all of such qualifying distributions directly for the active conduct of activities constituting its charitable purposes, the foundation does not satisfy the definition of an operating foundation unless it makes such distributions in an amount equal to substantially all of its adjusted net income.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably six copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is to be held, notice of the time and place will be published in the FEDERAL REGISTER.

REGULATORY FLEXIBILITY ACT

Although this document is a notice of proposed rulemaking which solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

DRAFTING INFORMATION

The principal author of these proposed regulations is Monice Rosenbaum of the Employee Plans and Exempt Organizations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

LIST OF SUBJECTS IN 26 CFR 53

Excise taxes, Foundations.

Proposed amendments to the regulations

The proposed amendments to 26 CFR part 53 are as follows:

Paragraph 1. Paragraph (b)(1) of §53.4942(a)-2 is revised to read as follows:

§53.4942(a)-2 Computation of undistributed income.

* * * * *

(b) *Distributable amount*—(1) *In general*. For purposes of paragraph (a) of this section, the term "distributable amount" means—

(i) For taxable years beginning before January 1, 1982, an amount equal to the greater of the minimum investment return (as defined in paragraph (c) of this section) or the adjusted net income (as defined in paragraph (d) of this section); and

(ii) For taxable years beginning after December 31, 1981, an amount equal to the minimum investment return (as defined in paragraph (c) of this section),

reduced by the sum of the taxes imposed on such private foundation for such taxable year under subtitle A of the Code and section 4940, and increased by the amounts received from trusts described in subparagraph (2) of this paragraph.

* * * * *

Par. 2. Paragraph (a)(1) of §53.4942(b)-1 is revised to read as follows:

§53.4942(b)-1 Operating foundations.

(a) *Operating foundation defined*—(1) *In general*. For purposes of section 4942 and the regulations thereunder, the term "operating foundation" means any private foundation which, in addition to satisfying the assets test, the endowment test or the support test set forth in §53.4942(b)-2(a), (b) and (c), makes qualifying distributions (within the meaning of §53.4942(a)-3(a)(2)) directly for the active conduct of activities constituting its charitable, educational, or other similar exempt purpose equal in value to—

(i) For taxable years beginning before January 1, 1982, substantially all of the foundation's adjusted net income (as defined in §53.4942(a)-2(d)); and

(ii) For taxable years beginning after December 31, 1981, substantially all of the lesser of the foundation's adjusted net income (as defined in §53.4942(a)-2(d)) or minimum investment return (as defined in §53.4942(a)-2(c)). If the foundation's qualifying distributions exceed its minimum investment return (but are less than the foundation's adjusted net income) substantially all of such qualifying distributions must be made directly for the active conduct of activities constituting its charitable, educational or other similar exempt purpose. However, if the foundation's minimum investment return is less than its adjusted net income and the foundation's qualifying distributions equal or exceed such adjusted net income, only that portion of the qualifying distributions equal to substantially all of the foundation's adjusted net income must be made directly for the active conduct of activities constituting its charitable, educational or other similar exempt purpose.

* * * * *

ROSCOE L. EGGER, JR.,
Commissioner of
Internal Revenue.

(Filed by the Office of the Federal Register on May 12, 1982, 8:45 a.m., and published in the issue of the Federal Register for May 13, 1982, 47 F.R. 20629)

Notice of Proposed Rulemaking

Special Lien For Additional Estate Tax Attributable To Farm, Etc., Special Use Valuation.

LR-201-76

SUMMARY: This document contains proposed regulations implementing the special lien for additional estate tax imposed under section 2032A(c) of the Code that was added by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1, 332]. The proposed regulation reflects changes made by the Technical Corrections Act of 1979 [Pub. L. 96-222, 1980-1 C.B. 499] and the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256], and affects qualified heirs of decedents whose estates elect to come within the special use valuation provisions of section 2032A.

DATES: Written comments and requests for a public hearing must be delivered or mailed by July 19, 1982. The regulations are effective for the estates of decedents dying after December 31, 1976.

ADDRESS: Send comments and requests for a public hearing to: Commander of Internal Revenue, Attention:CC:LR:T (LR-201-76) Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Fred E. Grundeman of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. Attention CC:LR:T 202-566-3287, not a toll-free number.

SUPPLEMENTARY INFORMATION:

BACKGROUND

Section 2032A of the Code provides that certain qualified real property may, for estate tax purposes, be valued at its special use value rather than its fair market value. Section 6324B of the Code, enacted by section 2003(b) of the Tax Reform Act of 1976 (Pub. L. 94-455, 90 Stat. 1861 [1976-1 C.B. (Vol. 1) 1, 377]), imposes a special lien on the qualified real property in the amount of the estate tax savings. Section 6324B was amended by section 108(d) of the Technical Corrections Act of 1979 (Pub. L. 96-222, 94 Stat. 228 [1980-1 C.B. 499, 517]), which extended the special lien to qualified replacement property, and by section 421(d)(2)(B) of the Economic Recovery Tax Act of 1981 (Pub. L. 97-34, 95 Stat. 309 [1981-2 C.B. 256, 327]), which extended the special lien to cover qualified exchange property. The proposed regulations are issued under the authority contained in sections 6324B (90 Stat. 1861, 26 U.S.C. 6324B) and 7805 (68A Stat. 917, 26 U.S.C. 7805) of the Code.

The purpose of this proposed regulation is to implement the special lien provisions and to grant authority to district directors to allow adequate security to be substituted for the special lien.

REGULATORY FLEXIBILITY ACT

Although this document is a notice of proposed rulemaking that solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. Chapter 6).

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably 6 copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying.

A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

DRAFTING INFORMATION

The principal author of these proposed regulations is Fred E. Grundeman of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and the Treasury Department participated in developing the regulations, both on matters of substance and style.

* * * * *

Proposed amendments to the regulations

The proposed amendments to 26 CFR Part 20 are as follows:

Paragraph 1. There is inserted immediately after §20.6324A-1 the following new section:

§20.6324B-1 Special lien for additional estate tax attributable to farm, etc., valuation.

(a) *General rule.* In the case of an estate of a decedent dying after December 31, 1976, which includes any interest in qualified real property, if the executor elects to value part or all of such property pursuant to section 2032A, a lien arises in favor of the United States on the property to which the election applies. The lien is in the amount equal to the adjusted tax difference attributable to such interest (as defined by section 2032A(c)(2)(B)). The term "qualified real property" means qualified real property as defined in section 2032A(b), qualified replacement property within the meaning of section 2032A(h)(3)(B), and qualified exchange property within the meaning of section 2032A(i)(3). The rules set forth in the regulations under section 2032A shall apply in determining whether this section is applicable to otherwise qualified real property held by a partnership, corporation or trust.

(b) *Period of lien.* The lien shall arise at the time the executor files an election under section 2032A. It shall remain in effect until one of the following occurs:

(1) The liability for the additional estate tax under section 2032A(c) with respect to such interest has been satisfied; or

(2) Such liability has become unenforceable by reason of lapse of time; or

(3) The district director is satisfied that no further liability for additional estate tax with respect to such interest may arise under section 2032A(c), i.e., the required time period has elapsed since the decedent's death without the occurrence of an event described in section 2032A(c)(1), or the qualified heir (as defined in section 2032A(e)(1) has died.

For procedures regarding the release or subordination of liens or discharge of property from liens, see §301.6325-1 of this chapter (Regulations and Procedure and Administration).

(c) *Substitution of security for lien.* The district director may, upon written application of the qualified heir (as defined in section 2032A(e)(1)) acquiring any interest in qualified real property to which a lien imposed by section 6324B attaches, issue a certificate of discharge of any or all property subject to such lien, after receiving a bond or other security in an amount or value determined by the district director as sufficient security for the maximum potential liability for additional estate tax with respect to such interest. Any bond shall be in the form and with the security prescribed in §301.7101-1 of this chapter.

(d) *Special rules.* The rules set forth in section 6324A(d)(1), (3), and (4), and the regulations thereunder, shall apply with respect to a lien imposed by section 6324B as if it were a lien imposed by section 6324A.

Par. 2. Section 301.6325-1 is amended by inserting a new sentence immediately after the second sentence of paragraph (c)(1), by redesignating (d)(3) as (d)(4), and by inserting a new paragraph (d)(3). These amended and added provisions read as follows:

§301.6325-1 Release of lien or discharge of property.

* * * * *

(c) *Estate or gift tax liability fully satisfied or provided for*—(1) *Certificate of discharge.* *** If a lien has arisen under section 6324B (relating to special lien for additional estate tax attributable to farm, etc., valuation) and the district director determines that the liability for additional estate tax has been fully secured in accordance with §20.6324B-1(c) of this chapter, the district director may issue a certificate of discharge of the real property from the section 6324B lien.***

* * * * *

(d) *Subordination of lien.****

(3) *Subordination of section 6324B lien.* The district director may issue a certificate of subordination with respect to a lien imposed by section 6324B if the district director determines that the interests of the United States will be adequately secured after such subordination. For example, *A*, a qualified heir of qualified real property, needs to borrow money for farming purposes. If the current fair market value of the real property is $150,000, the amount of the claim to which the special lien is to be subordinated is $40,000, the potential liability for additional tax (as defined in section 2032A(c)) is less than $55,000, and there are no other facts to indicate that the interest of the United States will not be adequately secured, the district director may issue a certificate of subordination. The result would be the same if the loan were for bona fide purposes other than farming.

* * * * *

ROSCOE L. EGGER, JR.,
Commissioner of
Internal Revenue.

(Filed by the Office of the Federal Register on May 21, 1982, 8:45 a.m., and published in the issue of the Federal Register for May 24, 1982, 47 F.R. 22388)

Notice of Proposed Rulemaking

Withholding From Amounts Paid Under Accident or Health Plans

LR-74-77

SUMMARY: This document contains proposed amendments to the regulations relating to withholding from amounts paid under accident or health plans. Changes to the applicable tax law were made by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1] and the Tax Reduction and Simplification Act of 1977 [Pub. L. 95-30, 1977-1 C.B. 451]. The amendments to the regulations would provide guidance to employers who pay amounts under accident or health plans and employees who receive amounts under accident or health plans.

DATES: Written comments and requests for a public hearing must be delivered by April 12, 1982. The regulations are proposed to be effective with respect to amounts paid under accident or health plans in taxable years beginning on or after January 1, 1977.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-74-77), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Barry L. Wold of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3828).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) and the Employment Tax Regulations (26 CFR Part 31) under sections 3401, 3402, 6001, and 6041 of the Internal Revenue Code of 1954. The proposed amendments to the regulations are necessary because of certain changes made to section 105(d) of the Code by section 505 of the Tax Reform Act of 1976 (Pub. L. 94-455 [1976-3 C.B. (Vol. 1) 1, 42]; 90 Stat. 1520, 1566) and by section 301 of the Tax Reduction and Simplification Act of 1977 (Pub. L. 95-30 [1977-1 C.B. 451, 466]; 91 Stat. 126, 151). These statutory changes are effective with respect to amounts paid under accident or health plans in taxable years beginning on or after January 1, 1977. These regulations are proposed to be issued under the authority contained in section 7805 of the Internal Revenue Code (68A Stat. 917; 26 U.S.C. 7805).

GENERAL RULE

The proposed amendments to the regulations would require an employer to withhold income taxes from amounts paid to an employee by the employer under an accident or health plan in taxable years beginning on or after January 1, 1977. Special rules exempt from this requirement certain payments made under sections 105(d), 3401(a), 3402(e), 3402(n), and 3402(o) of the Internal Revenue Code. The proposed amendments also would require returns of information on disability payments under section 105(d) of the Code.

REGULATORY FLEXIBILITY ACT

Although this document is a notice of proposed rulemaking which solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably six copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

DRAFTING INFORMATION

The principal author of these proposed regulations is Barry L. Wold of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, on matters of both substance and style.

Proposed amendments to the regulations

The proposed amendments to 26 CFR Parts 1 and 31 are as follows:

Paragraph 1. A new subparagraph (4) is added to §1.6041-1(d) and is inserted after subparagraph (3) of that section. The new material reads as follows:

§1.6041-1 Return of information as to payments of $600 or more.

* * * * *

(d) *Payments specifically included.****

(4) Amounts paid as disability payments under section 105(d) are required to be reported in returns of information under this section.

* * * * *

Par. 2. Section 31.3401(a)-1(b)(8) is amended by revising subdivision (i) thereof and by striking from the first sentence of the flush material following subdivision (ii)(*b*)(*1*)(*ii*): "after August 1, 1977, the thirtieth day after the publication of this regulation in the FEDERAL REGISTER as a Treasury decision (and, at the option of the employer, such payments reasonably expected to be made prior thereto)". The revised provision reads as follows:

§31.3401(a)-1 Wages.

* * * * *

(b) *Certain specific items.****

(8) *Amounts paid under accident or health plans*—(i) *Amounts paid in taxable years beginning on or after January 1, 1977*—(*a*) *In general.* Withholding is required on all payments of amounts includible in gross income under section 105(a) and §1.105-1 (relating to amounts attributable to employer contributions), made in taxable years beginning on or after January 1, 1977, to an employee under an accident or health plan for a period of absence from work on account of personal injuries or sickness. Payments on which withholding is required by this subdivision are wages as defined in section 3401(a), and the employer shall deduct and withhold in accordance with the requirements of chapter 24 of subtitle C of the Code. Third party payments of sick pay, as defined in section 3402(o) and the regulations thereunder, are not wages for purposes of this section.

(*b*) *Payments made by an agent of the employer.* Payments are considered made by the employer if a third party makes the payments as an agent of the employer. The determining factor as to whether a third party is an agent of the employer is whether the third party bears any insurance risk. If the third party bears no insurance risk and is reimbursed on a cost plus fee basis, the third party is an agent of the employer even if the third party is responsible for making determinations of the eligibility of individual employees of the employer for sick pay payments. If the third party is paid an insurance premium and not reimbursed on a cost plus fee basis, the third party is not an agent of the employer, but the third party is a payor of third party sick pay for purposes of voluntary withholding from sick pay under sections 3402(o) and 6051(f) and the regulations thereunder.

(*c*) *Exceptions to withholding.* (*1*) Withholding is not required on payments that are specifically excepted under the numbered paragraphs of section 3401(a) (relating to the definition of wages), under section 3402(e) (relating to included and excluded wages), or under section 3402(n) (relating to employees incurring no income tax liability).

(2) Withholding is not required on disability payments to the extent that the payments are excludable from gross income under section 105(d). In determining the excludable portion of the disability payments, the employer may assume that payments that the employer makes to the employee are the employee's sole source of income. This exception applies only if the employee furnishes the employer with adequate verification of disability. A certificate from a qualified physician attesting that the employee is permanently and totally disabled (within the meaning of section 105(d)) shall be deemed to constitute adequate verification. This exception does not affect the requirement that a statement (which includes any amount paid under section 105(d)) be furnished under either section 6041 (relating to information at source) or section 6051 (relating to receipts for employees) and the regulations thereunder.

Par. 3. Section 31.3402(a)-1(d) is amended to read as follows:

§31.3402(a)-1 Requirement of withholding.

* * * * *

(d) For provisions relating to the circumstances under which tax is required to be deducted and withheld from certain amounts received under accident and health plans, see paragraph (b)(8) of §31.3401(a)-1.

* * * * *

Par. 4. Section 31.3402(b)-1(a)(3) (relating to percentage method of withholding) is amended by deleting "wage continuation plans" and inserting in lieu thereof "accident and health plans".

Par. 5. Section 31.3402(c)-1(a)(2) (relating to wage bracket withholding) is amended by deleting "wage continuation plans" and inserting in lieu thereof "accident and health plans".

Par. 6. Section 31.6001-5(a) (relating to additional records in connection with collection of income tax at source on wages) is amended by deleting subparagraph (11) therefrom and by deleting from subparagraph (12) "a wage continuation plan (as defined in paragraph (a)(2)(i) of §1.105-4 and §1.105-5 of this chapter (Income Tax Regulations))—" and inserting in lieu thereof "an accident or health plan (as defined in section 105 and the regulations thereunder)—".

ROSCOE L. EGGER, JR.,
Commissioner of
Internal Revenue.

(Filed by the Office of the Federal Register on February 10, 1982, 9:50 a.m., and published in the issue of the Federal Register for February 12, 1982, 47 F.R. 6440)

Notice of Proposed Rulemaking

Partial Exclusion of Dividends and Interest

LR-83-80

SUMMARY: This document contains proposed regulations relating to the partial exclusion of dividends and interest from gross income. The applicable law was amended by the Crude Oil Windfall Profit Tax Act of 1980 [Pub. L. 96-223, 1980-3 C.B. 2] and the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256]. The statutory amendments expanded the scope of the exclusion to include interest in addition to dividends and increased the amount of the exclusion for taxable years beginning in 1981. The regulations would provide individuals and certain payors of interest and dividends with guidance in determining what portion of dividends and interest received during an individual's taxable year beginning in 1981 is eligible for the exclusion.

DATES: Written comments and requests for a public hearing must be delivered or mailed by April 12, 1982. The amendments are proposed to be effective for dividends and interest received by an individual in the individual's taxable year beginning in 1981.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-83-80), [1111 Constitution Ave., N.W.] Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Phoebe A. Mix of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 202-566-3297, not a toll-free call.

SUPPLEMENTARY INFORMATION

BACKGROUND

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under sections 116, 854, 857, and 1232 of the Internal Revenue Code of 1954. These amendments are proposed to conform the regulations to section 404 of the Crude Oil Windfall Profit Tax Act of 1980 (Pub. L. 96-223, 94 Stat. 305 [1980-3 C.B. 2, 77]) and section 302(b)(1) of the Economic Recovery Tax Act of 1981 (Pub. L. 97-34, 95 Stat. 272 [1981-2 C.B. 256, 309]). The amendments are to be issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

EXPLANATION OF AMENDMENTS

Section 116 of the Internal Revenue Code prior to amendment by the Crude Oil Windfall Profit Tax Act provided an exclusion from gross income of $100 of dividends received by an individual. A married couple filing a joint return could exclude $200 if each spouse received at least $100 of dividends. For taxable years beginning in 1981 and 1982, section 404 of the Crude Oil Windfall Profit Tax Act increased the amount of the exclusion to $200 for individuals ($400 for married couples filing joint returns, without regard to which spouse received the dividends) and expanded the exclusion to apply to certain types of interest received by individuals from domestic corporations. Section 302 (b)(1) of the Economic Recovery Tax Act of 1981 limited these amendments to taxable years beginning in 1981.

Section 116(c)(1) lists five categories of indebtedness interest on which qualifies for the exclusion; it also provides that the list may be expanded through regulations to include other evidences of indebtedness issued by a domestic corporation of a type offered by corporations to the public. The proposed regulations add commercial paper and repurchase agreements to the list and provide that original issue discount with respect to any listed category of indebtedness shall be treated as qualifying interest. In addition, the proposed regulations would provide that original issue discount excluded under section 116 would be considered included in gross income under the basis adjustment provisions of section 1232(a)(3)(E). The result would be that even though original issue discount is excluded from gross income under section 116 it would be added to the bondholder's basis in the obligation under section 1232 (a)(3)(E).

In the case of distributions received by individuals from conduit-type entities (such as trusts, regulated investment companies, and real estate investment trusts), sections 116, 854 and 857 as amended provide that the distributions generally qualify for the exclusion to the same extent that the gross income of the entity consists of eligible dividends or eligible interest. The proposed regulations would provide that the taxable year of the individual in which the individual receives the distribution will determine the amount and the scope of the distribution which the taxpayer may exclude from gross income under section 116.

Under the proposed regulations, a regulated investment company or a real estate investment trust would compute the percentage of gross income which qualifies for the exclusion on the basis of its gross income for its taxable year but would use the date of distribution to the shareholder to determine which items qualify for exclusion. To simplify preparation of notices to shareholders with respect to the excludability of dividends, the proposed regulations would provide that the entity could assume that the taxable year of all recipient shareholders is the calendar year. Shareholders whose taxable year is not the calendar year would be allowed to request a special notice from the entity based on the shareholder's different taxable year.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably six copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

REGULATORY FLEXIBILITY ACT

Although this document is a notice of proposed rulemaking which solicits public comment, the Internal Revenue Service has concluded that the regulations proposed are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

DRAFTING INFORMATION

The principal author of these proposed regulations in Phoebe A. Mix of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Proposed amendments to the regulations

The proposed amendments to 26 CFR Part 1 are as follows:

Paragraph 1. The following new section is to be inserted after §1.116-2.

§1.116-3 Special rules for taxable years beginning after December 31, 1980 and before January 1, 1982.

(a) *In general.* This section provides special rules for taxable years beginning after December 31, 1980 and before January 1, 1982. The provisions of §1.116-1 are applicable to those taxable years to the extent that those provisions are consistent with the rules of this section. References to "dividends" in §1.116-1 shall be deemed to be references to "interest" as well, where appropriate for purposes of this section.

(b) *Amount excludable.* Section 116 excludes from gross income the first $200 of dividends from domestic corporations and interest received by an individual in a taxable year which begins after December 31, 1980, and before January 1, 1982. In the case of a joint return, the first $400 of dividends from domestic corporations and interest may be excluded, without regard to which spouse was the actual recipient of the dividends and interest.

(c) *Interest defined*—(1) *In general.* The only payments or credits included within the term "interest" for purposes of section 116 are enumerated in section 116(c)(1) and paragraph (c)(4) of this section.

(2) *Evidences of indebtedness issued in a registered form.* The phrase "evidences of indebtedness" includes bonds, debentures, notes, certificates and other similar instruments regardless of how denominated. An evidence of indebtedness is in registered form if it is registered as to both principle and interest (or, for purposes of reporting with respect to original issue discount, if it is registered as to principal) and if its transfer must be effected by the surrender of the old instrument and either the reissuance by the corporation of the old instrument to the new holder or the issuance by the corporation of a new instrument to the new holder.

(3) *Original issue discount.* Original issue discount that, prior to application of section 116, would be properly includable in income in the taxable year shall be considered interest for purposes of the exclusion provided in section 116, if interest on the underlying obligation (if the obligation were interest-bearing) would be interest within the meaning of section 116 (c)(1). See §1.1232-3A(c) for rules relating to adjustments to basis in respect of any original issue discount excluded from gross income under the provisions of this paragraph.

(4) *Other evidences of indebtedness issued by a domestic corporation.* Interest paid in respect of commercial paper issued by a domestic corporation and interest paid pursuant to a repurchase agreement with a domestic corporation shall be considered interest for purposes of section 116.

(d) *Distributions from real estate investment trusts.* Distributions from real estate investment trusts qualify for exclusion under section 116 to the extent provided in section 857(c) and §1.857-6(d)(2).

(e) ***Time dividends and interest are received.*** The general rule provided in §1.116-1(f), relating to the determination of when dividends are received, shall apply for purposes of determining the amount of the exclusion applicable to dividends or interest received by a beneficiary from an estate or trust. The special rule provided in §1.116-1(g) shall not apply to amounts includible in income of beneficiaries for taxable years beginning after December 31, 1980 and before January 1, 1982.

Par. 2. Section 1.854-1 is amended by adding new paragraphs (c)(4) and (e). These new paragraphs read as follows:

§1.854-1 Limitations applicable to dividends received from regulated investment company.

* * * * *

(c) *Rule for dividends other than capital gains.*

* * * * *

(4) For special rules with respect to dividends received in a taxable year of the shareholder beginning after December 31, 1980, and before January 1, 1982, see paragraph (e) of this section.

* * * * *

(e) *Special rule for dividends (other than capital gain dividends) for taxable years beginning after December 31, 1980 and before January 1, 1982*—(1) *In general.* In the case of a dividend (other than a capital gain dividend) received from a regulated investment company (which meets the requirements of section 852(a) for the taxable year during which it paid the dividend) by a shareholder in a taxable year of the shareholder which begins after December 31, 1980 and before January 1, 1982, this paragraph shall apply.

(2) *Portion of the dividend eligible for exclusion under section 116*—(i) *Entire amount.* When either the aggregate interest received or the aggregate dividends received by a regulated investment company constitute at least 75 percent of its gross income for that taxable year, the entire dividend paid by the regulated investment company to the shareholder may be treated as an amount qualifying for exclusion under section 116.

(ii) *Partial amount.* When the aggregate interest received by a regulated investment company during a taxable year is less than 75 percent of its gross income and the aggregate dividends received by it are less than 75 percent of its gross income, the portion of the dividend received by the shareholder that may be treated as an amount qualifying for exclusion under section 116 is that amount that bears the same ratio to the amount of the entire dividend as the sum of the aggregate dividends and the aggregate interest received by the regulated investment company bears to the gross income of the regulated investment company.

(iii) *Adjustment for interest deduction.* For purposes of computing the portion of the dividend eligible for the exclusion under section 116, gross income and aggregate interest received shall each be reduced by the lesser of—

(A) The deduction allowable by section 163 for the taxable year, or

(B) The aggregate interest received for the taxable year (computed without regard to this subdivision).

(iv) *Gross income.* For purposes of this paragraph, the term "gross income" does not include gain from the sale or other disposition of stock or securities.

(v) *Aggregate dividends received.* For purposes of this paragraph, the term "aggregate dividends received" includes only dividends received from domestic corporations other than dividends described in section 116(b)(2) (relating to dividends not eligible for exclusion from gross income). Accordingly dividends received from foreign corporations will not be included in the computation of "aggregate dividends received".

(vi) *Aggregate interest received.* For purposes of this paragraph, the term "aggregate interest received" includes only interest described in section 116(c)(1) and §1.116-3(c).

(3) *Notice to shareholders.* In preparing the notice to shareholders described in section 854(b)(3) and §1.854-2, the regulated investment company shall assume:

(i) That the taxable year of every shareholder is the calendar year, and

(ii) That all dividends are received by shareholders on the date on whi
they are distributed by the regulat
investment company.

The regulated investment compa
shall upon request provide any shar
holder with respect to whom these a
sumptions result in an erroneous d
termination for purposes of sectio
116 a special notice that takes into a
count the actual facts of the case. Th
special notice shall be deemed to be
timely notice for purposes of sectio
854(b)(3) if it is mailed within 45 da
of the date that the regulated inves
ment company receives a request fro
a shareholder.

(4) *Examples.* The following e
amples illustrate the provisions of th
paragraph:

Example (1). (i) R, a regulated investme
company having a fiscal year ending June 3
makes regular distributions to its sharehold
on September 1, December 1, March 1, a
June 1 each year.

(ii) For its taxable year ending June 30, 198
R has the following items of gross income:

$ 66,000	Dividends (all of which quali for exclusion under secti 116).
35,000	Interest (all of which qualifi for exclusion under section 11
5,000	Capital gains from the sale of s curities
6,000	Other income
$112,000	

R has $7,000 of interest expenses which are d
ductible under section 163 for its taxable ye
ending June 30, 1981.

(iii) In computing the portion of the distrib
tions that may qualify for exclusion under se
tion 116, R assumes that its shareholders a
calendar year taxpayers who receive di
tributions on the date of distribution. Ther
fore, R assumes that its shareholders receiv
the September and December distributions
the taxable year beginning January 1, 1980 a
the March and June distributions in the taxab
year beginning January 1, 1981. Applying t
rules of paragraph (c) of this section, R dete
mines that 61.68 percent (66/107) of the Se
tember and December distributions (other th
capital gains dividends) may be excluded.
applies the rules of this paragraph (e) to dete
mine the portion of the March and June di
tributions that qualifies for exclusion under se
tion 116.

(iv) For purposes of computing the portion
the March and June distributions that qualifi
for exclusion under section 116, R's gross i
come is deemed to be $100,000 and R's a
gregate interest is deemed to be $28,000. The
amounts are determined as follows:

$112,000	gross income received
− 5,000	capital gains from sale of secu ties
107,000	gross income prior to adju ment for interest expense
− 7,000	interest expense
$100,000	gross income net of interest pense
$ 35,000	aggregate interest received pr to adjustment for interest pense

– 7,000	interest expense
$ 28,000	aggregate interest received net of interest expense

(v) Neither the aggregate dividends received ($66,000) nor the aggregate interest received ($28,000) constitute at least 75 percent of R's gross income ($100,000). Therefore it is necessary to determine what portion of the dividend qualifies for the partial exclusion under section 116. Applying the rules of paragraph (e), R determines that 94 percent ($66,000 + $28,000/$100,000) of the March and June distributions (other than capital gains dividends) qualify for the partial exclusion under section 116.

Example (2). Assume the same facts as in example (1), except that S is a fiscal year taxpayer whose taxable year ends March 31. In July, 1981, S requests that R provide S with a special notice taking into account the fact that S is a fiscal year taxpayer and designating the amount of each dividend eligible for the section 116 exclusion. Within 45 days, R notifies S that 61.68 percent of the September, December, and March distributions and 94 percent of the June distribution will qualify for exclusion. The excludable portion of the March 1981 dividend is computed under the rules of paragraph (c) of this section because S received the dividend in a taxable year of S which began before January 1, 1981.

Example (3). Assume the same facts as in example (1), except that in addition to the four regular distributions R declares a dividend on July 15, 1981 which it distributes to its shareholders on August 28, 1981. R elects under section 855 to treat the August dividend as paid in its taxable year ending June 30, 1981. Because of this election, R refers to its gross income for its taxable year ending June 30, 1981, for purposes of determining what percentage of the August dividend qualifies for exclusion under section 116. R assumes that its shareholders use the calendar year as the taxable year and that the shareholders receive the dividend on August 28, 1981, the date of distribution. Therefore, R notifies the shareholders that 94 percent of the August dividend qualifies for exclusion under section 116.

Example (4). Assume the same facts as in example (3) except that R distributes the dividend on January 2, 1982, and does not make the regular distributions in September and December of 1981. Since the shareholders receive the distribution in 1982 and since interest cannot be excluded under section 116 in 1982, R takes only excludable dividends into account in determining the percentage of the distribution that qualifies for exclusion. Therefore R notifies its shareholders that 61.68 percent (see paragraph (iii) of example (1)) of the January dividend qualifies for exclusion under section 116.

Par. 3. Paragraph (d) of §1.857-6 is amended to read as follows:

§1.857-6 Method of taxation of shareholders of real estate investment trusts.

* * * * *

(d) *Dividend received credit, exclusion, and deduction not allowed.* (1) *In general.* Any dividend received from a real estate investment trust which, for the taxable year to which the dividend relates, is a qualified real estate investment trust shall not be eligible for the dividend received exclusion under section 116 (except as provided in subparagraph (2) of this paragraph), or the dividend received deduction under section 243.

(2) *Special rule for dividends (other than capital gain dividends) for taxable years beginning after December 31, 1980 and before January 1, 1982*—(i) *In general.* In the case of dividends (other than capital gain dividends) received from a real estate investment trust by a shareholder in a taxable year of the shareholder which begins after December 31, 1980, and before January 1, 1982, this subparagraph shall apply.

(ii) *Portion of the dividend eligible for exclusion under section 116.* (A) *Entire amount.* When the aggregate interest received by the real estate investment trust constitutes at least 75 percent of its gross income for the taxable year, the entire dividend received by the shareholder may be treated as an amount qualifying for exclusion under section 116.

(B) *Partial amount.* When the aggregate interest received by the real estate investment trust during its taxable year is less than 75 percent of its gross income, the portion of the dividend received by the shareholder that may be treated as an amount qualifying for exclusion under section 116 is that amount that bears the same ratio to the entire dividend as the aggregate interest received by the real estate investment trust bears to its gross income.

(C) *Adjustment for interest deduction.* For purposes of computing the portion of the dividend eligible for exclusion under section 116, gross income (within the meaning of paragraph (d)(2)(ii)(D) of this section) and aggregate interest received (within the meaning of paragraph (d)(2)(ii)(E) of this section) shall each be reduced by the lesser of the deduction allowable by section 163 for the taxable year (other than for interest on mortgages on real property owned by the real estate investment trust), or the aggregate interest received for the taxable year (computed without regard to this subdivision (C)).

(D) *Gross income.* For purposes of this paragraph, the term "gross income" means gross income reduced by the sum of the net capital gain of the real estate investment trust in the taxable year and the taxes imposed by paragraphs (4), (5) and (6) of section 857(b).

(E) *Aggregate interest received.* For purposes of this paragraph, the term "aggregate interest received" means interest described in section 116(c)(1) and §1.116-3(c).

(iii) *Notice to shareholders.* In preparing the notice to shareholders described in section 857(c)(5), the real estate investment trust shall assume—

(A) That all shareholder recipients are calendar year taxpayers, and

(B) That all dividends are received by the shareholders on the date they are distributed by the real estate investment trust.

The real estate investment trust shall upon request provide any shareholder with respect to whom these assumptions result in an erroneous determination for purposes of section 116 a special notice that takes into account the actual facts of the case. The special notice shall be deemed to be a timely notice for purposes of 857(c)(5) if it is mailed within 45 days of the date that the real estate investment trust receives a request from a shareholder for such a notice.

(3) *Examples.* The following examples illustrate the provisions of this paragraph:

Example (1) (i) R, a real estate investment trust having a fiscal year ending June 30, makes regular distributions to its shareholders on December 1 and June 1 of each year.

(ii) In its fiscal year ending June 30, 1981, R has $115,000 of gross income, $80,000 of which is interest income and $7,000 of which is net capital gains. R has $40,000 of interest expenses which are deductible by R under section 163 in its taxable year ending June 30, 1981, $32,000 of which represents interest paid on mortgages on real property owned by R. No tax is imposed on R under section 857(b)(4),(5), or (6) for that taxable year.

(iii) In computing the portion of the distributions (other than amounts designated as capital gains dividends) that may qualify for exclusion under section 116, R assumes that its shareholders are calendar year taxpayers who receive distributions on the date of distribution. Therefore, R applies the rules of paragraph (d)(1) of this section to determine that no portion of the December 1980 distribution qualifies for exclusion under section 116. R applies the rules of paragraph (d)(2) of this section to determine the portion of the June distribution that qualifies for exclusion under section 116 because it is assumed that that distribution is received by shareholders in a taxable year beginning in 1981.

(iv) For purposes of computing the portion of the June distribution that qualifies for exclusion under section 116, R's gross income is deemed to be $100,000 and R's aggregate interest received is deemed to be $72,000. These amounts are determined as follows:

$115,000	gross income received
− 7,000	net capital gains
$108,000	gross income prior to adjustment for interest expense
− 8,000	interest expense
$100,000	gross income net of interest expense
$ 80,000	aggregate interest received prior to adjustment for interest expense
− 8,000	
$ 72,000	aggregate interest received net of interest expense

(v) The aggregate interest received does not exceed 75 percent of R's gross income. Therefore, R notifies its shareholders that 72% of the June distribution (other than capital gains dividends) qualifies for exclusion under section 116.

Example (2). Assume the same facts as in example (1), except that in addition to its regular distributions R declares a dividend August 1, 1981 which it distributes to its shareholders November 1, 1981. R elects under section 858 to treat the November dividend as paid in its taxable year ending June 30, 1981. Because of this election, R refers to its gross income for its taxable year ending June 30, 1981, for purposes of determining what percentage of the November dividend qualifies for exclusion under section 116. R assumes that its shareholders use the calendar year as the taxable year and that the shareholders receive the dividend on November 1, 1981, the date of distribution. Therefore R notifies its shareholders that 72 percent of the November dividend qualifies for exclusion under section 116.

Example (3). Assume the same facts as in example (2) except that R distributes the dividend on January 2, 1982 and does not make the regular distribution in December of 1981. Since the shareholders receive the distribution in 1982 and since interest cannot be excluded under section 116 in 1982, R determines that no portion of the January distribution qualifies for exclusion under section 116.

* * * * *

Par. 4. Paragraph (c) of §1.1232-3A is amended by adding the following new sentence at the end:

§1.1232-3A Inclusion as interest of original issue discount on certain obligations issued after May 27, 1969.

* * * * *

(c) *Basis adjustment.* *** Any original issue discount that is considered interest and excluded from gross income under section 116 and §1.116-3(c)(3) will be considered included in gross income for purposes of the basis adjustment under section 1232(a)(3)(E) and this section.

* * * * *

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on February 4, 1982, 5:07 p.m., and published in the issue of the Federal Register for February 9, 1982, 47 F.R. 5902)

Notice of Proposed Rulemaking

Subsidized Borrowings Reduce Business Energy Credits

LR-176-80

SUMMARY: This document contains proposed regulations relating to the rule which reduces the energy credit where energy property is financed by subsidized energy financing or tax-exempt industrial development bonds. Changes to the applicable tax law were made by the Energy Tax Act of 1978 [Pub. L. 95-618, 1978-3 C.B. (Vol. 1) 1], and the Crude Oil Windfall Profit Tax Act of 1980 [Pub. L. 96-223, 1980-3 C.B. 2]. These regulations will provide the public with the guidance needed to comply with the law.

DATES: Written comments and requests for a public hearing must be delivered or mailed by March 29, 1982. This amendment is proposed to be effective for certain periods after October 1, 1978.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attn: CC:LR:T (LR-176-80) Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Mary Frances Pearson of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attn: CC:LR:T) (202-566-3458; not a toll-free number).

SUPPLEMENTAL INFORMATION:

BACKGROUND

This document contains a proposed amendment to the Income Tax Regulations (26 CFR Part 1) under section 48 of the Internal Revenue Code of 1954. This amendment is proposed to conform the regulations to changes made by section 301(b) of the Energy Tax Act of 1978 (Pub. L. 95-618, [1978-3 C.B. (Vol. 1) 1, 54] 92 Stat. 3195) and sections 221(b)(2) and 223(c) of the Crude Oil Windfall Profit Tax Act of 1980 (Pub. L. 96-223, [1980-3 C.B. 2, 32, 33, 38] 94 Stat. 229). The proposed regulations are to be issued under the authority contained in Code sections 7805 (68A Stat. 917, 26 U.S.C. 7805) and 38(b) (76 Stat. 962, 26 U.S.C. 38).

EXPLANATION OF PROVISIONS

In general, the energy percentage, as determined under section 46(a)(2)(C), is applied to the total amount of qualified investment in energy property to establish the amount of credit allowed. Section 301(b) of the Energy Tax Act of 1978 added section 48(l)(11) to the Code. This provision in effect reduces the energy credit percentage by one half if the energy property is financed in whole or in part with the proceeds of tax-exempt industrial development bonds within the meaning of section 103(b)(2) (exempt IDB's). Sections 221(b)(2) and 223(c) of the Crude Oil Windfall Profit Tax Act of 1980 amended section 48(l)(11) to reduce the qualified investment in energy property by the amount of financing attributable to the proceeds of exempt IDBs and subsidized energy financing.

The 1980 Act amendments apply for the period after December 31, 1979, in the case of property qualifying under the 1980 Act as energy property for the first time. This property is called "early application property" and is described in §1.48-9(o)(9) of the proposed amendments to the regulations. For all other energy property, the 1980 Act amendments apply for the period after December 31, 1982.

For example, assume a taxpayer acquires and places in service recycling equipment (which is not early application property) and finances the acquisition in part with exempt IDB's. If the equipment is acquired and placed in service before January 1, 1983, then to determine the credit for energy property, the energy percentage is reduced by one-half and then is multiplied against the total qualified investment in that property. If the equipment is acquired and placed in service after December 31, 1982, the qualified investment is reduced by the amount of the financing attributable to the exempt IDB's and the full energy credit is multiplied against the reduced qualified investment.

Subsidized energy financing

Section 48(l)(11), as amended by section 223(c) of the Crude Oil Windfall Profit Tax Act, defines subsidized energy financing as financing provided under a Federal, State, or local program a principal purpose of which is to provide subsidized financing for projects designed to conserve or produce energy.

The proposed regulations follow the Conference Report, which indicates that loan guarantees, credits against State and local income taxes, and taxable grants are not subsidized energy financing. *See*, H.R. Rep. No. 96-817 [1980-3 C.B. 245], 96th Cong. 2d Sess. 136-137 (1980) (Conference Report). (For an example of a taxable energy grant, *see*, Rev. Rul. 79-356, 1979-2 C.B. 28). Non-taxable government grants also are not included within the definition of subsidized energy financing for purposes of the rule in section 48(l)(11). However, the same result is achieved for purposes of the energy credit since the basis of the property is determined with reference to cost under section 1012 and the amount of a non-taxable grant will not be taken into account in determining basis. Also, price guarantees and purchase commitments are not considered subsidized financing since these type of arrangements confer only a contingent benefit. However, if funds are advanced under a price guarantee or a purchase commitment agreement which, in effect, results in a loan (for example, where payments under the agreement are made before the project becomes operational), these advances are considered to be subsidized energy financing. The proposed regulations incorporate the substance of a colloquy between Senators Baker and Long on the Senate floor that subsidized energy financing does not include funds received by government owned utilities if the source of the funds is from rate-payers from the sale of services and no tax revenues are involved. *See*, 126 Cong. Rec. S. 3052 (daily ed. March 26, 1980); Rev. Rul. 81-52, 1981-1 C.B. 9.

Allocation

The statutory rule under section 48(l)(11) multiplies qualified investment by a fraction to determine the amount of qualified investment taken into account for the energy credit. The fraction is one minus another fraction the numerator of which is the portion of qualified investment in the property which is allocable to subsidized financing or proceeds of exempt IDB's and the denominator of which is the total qualified investment in the property before the application of this rule. The proposed regulations achieve the same result as the statute by simply reducing qualified investment for the energy credit by the portion attributable to the energy financing or proceeds.

The proposed regulations allocate the proceeds according to the type of borrowings used to finance the energy property. Borrowings attributable to subsidized energy financing are directly applied to reduce the qualified investment in energy property. The reason is that subsidized energy loans, *e.g.*, loans granted pursuant to the Energy Security Act (Pub. L. 96-294, 94 Stat. 611), have legal restraints on the use of loans by taxpayers. For example, under section 509(a)(1)(B)(ii) of that Act, proceeds must be used to acquire a specific type of energy property, *i.e.*, solar energy systems. On the other hand, the proceeds of exempt IDB's are ratably allocated between energy property and other property and then, once the allocation is made, the qualified investment in the energy property is reduced by the portion of exempt IDB financing attributed to the energy property.

The reason for this ratable allocation approach is to prevent tax avoidance. In general, proceeds from exempt IDB's can be applied to all property in a facility regardless of the mix of energy property or other property. In the absence of a ratable allocation rule, taxpayers in order to preserve the energy credit might attempt to allocate the proceeds first to non-energy property and only then, if any proceeds remain, to energy property.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably six copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

REGULATORY FLEXIBILITY ACT

Although this document is a notice of proposed rulemaking which solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

DRAFTING INFORMATION

The principal author of these proposed regulations is Mary Frances Pearson of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Proposed Amendments to the Regulations

The proposed amendments to the Income Tax Regulations (26 CFR Part 1) are as follows:

Section 1.48-9 is amended by adding a new paragraph (o) to read as follows:

(o) *Energy property financed by subsidized energy financing or industrial development bonds*—(1) *In general.* (i) This paragraph (o) prescribes rules—

(A) For reducing the qualified investment for purposes of the energy credit. See section 48(l)(11) as amended by section 223(c)(1) of the Crude Oil Windfall Profit Tax Act of 1980 (Pub. L. 96-223) and paragraph (o)(2) of this section.

(B) For reducing the energy credit percentage. See section 48(l)(11) as amended by section 221(b)(2) of that Act and paragraph (o)(6) of this section.

(ii) For effective dates, see paragraph (o)(8) of this section.

(2) *General rule*. For purposes of the energy credit, qualified investment in any energy property (determined without this paragraph (o)) is reduced by the amount of subsidized borrowed funds used to finance in whole or in part the energy property. Funds borrowed are subsidized if they are directly or indirectly attributable to the proceeds of exempt IDB's or subsidized energy financing.

(3) *Exempt IDB defined*. For purposes of this paragraph (c), an exempt IDB is an industrial development bond (within the meaning of section 103(b)(2)) with respect to which the interest paid is excluded from gross income under section 103.

(4) *Subsidized energy financing*. (i) Funds are attributable to subsidized energy financing if the source of the funds for financing (other than exempt IDB's) is provided directly or indirectly (such as in association with, or through the facilities of, a bank or other lender) by, or through, a government agency under a program a principal purpose of which is to provide (or assist in providing) financing for projects designed to conserve or produce energy. For purposes of this paragraph (o), a government agency is a State or local governmental unit referred to in §1.103-1(a) or the Federal government.

(ii) Subsidized energy financing does not include a grant includible in gross income under section 61, a nontaxable government grant, or a credit against State or local taxes. Loan guarantees, price guarantees, purchase commitments, price support loans, and similar arrangements are not considered subsidized energy financing unless the arrangement is essentially subsidized borrowing under subdivision (i) of this subparagraph (4).

(iii) The following examples illustrate this subparagraph (4).

Example (1). A law in State A requires, a part of its State-wide energy program, that public utilities in the State provide low-interest loans to business enterprises for the purchase of energy property. The utilities are able to make these low-interest loans available to the enterprises by charging a 2 percent surcharge on each utility service bill. The funds from the surcharge are kept separate in an escrow account. This type of low interest loan is not subsidized energy financing and will not reduce the qualified investment of any energy property purchased with these funds.

Example (2). Assume the same facts as in example (1) except that, in lieu of the surcharge, the utilities receive money from the State for the express purpose of providing energy loans. Any low-interest loans made from these funds will be considered subsidized energy financing.

Example (3). State B allows a tax credit to a financial institution which makes low interest loans to corporations for the purpose of acquiring energy devices. The financial institution receives a credit each year in the amount of the excess of the interest that would have been paid at market rates and the actual interest paid on such loans. The State B tax credit arrangement is an interest subsidy. Thus, any low-interest loans pursuant to this credit arrangement is considered subsidized energy financing.

Example (4). State C wishes to encourage the production of synthetic fuels. As an inducement to Corporation X to build a synthetic fuel production plant, C enters into a contract with X guaranteeing X a certain price for the first 1,000 barrels of daily production. Before the plant is operational and pursuant to the price guarantee commitment, X receives an interest free advance of $10,000. Since the advance of funds is essentially a subsidized energy loan, it is considered to be subsidized energy financing.

(5) *Allocation of proceeds*. (i) For purposes of the general rule, this subparagraph (5) sets forth the manner of determining the amount of subsidized borrowed funds that are considered used to finance energy property.

(ii) If borrowings attributable to subsidized energy financing are used to finance a facility, the entire amount of the borrowings are considered used to finance the energy property included in that facility and thus is applied directly to reduce the qualified investment in the energy property.

(iii)(A) If borrowings attributable to the proceeds of exempt IDB's are used to finance a facility, the borrowings reduce the qualified investment in that energy property. The amount of those borrowings considered used to finance energy property included in that facility equals the amount of the borrowings multiplied by a fraction. The numerator of the fraction is the qualified investment in the energy property before the reduction and the denominator is the total cost of that facility.

(B) If borrowings are attributable to the proceeds of exempt IDB's the exempt status of which is derived solely under section 103(b)(4), and the proceeds of such borrowings are used solely to finance the type of property or facility described in section 103(b)(4) from which the issue derives its tax-exempt status, then the facility referred to in paragraph (o)(5)(iii)(A) of this section is the property or facility from which the issue derives its tax-exempt status.

(iv) If both borrowings attributable to subsidized energy financing and borrowings attributable to exempt IDB financing are used to finance a facility, the total amount of subsidized energy financing is first applied directly to reduce the qualified investment (determined without this subdivision (iv)) in the energy property included in the facility. Then, paragraph (o)(5)(iii) of this section is applied to the exempt IDB financing by reducing both the numerator and the denominator of the fraction by the same total amount.

(v) The following examples illustrate this subparagraph (5).

Example (1). In 1983, Corporation X build a facility costing $10,000. The facility include energy property having a useful life of 7 year and the qualified investment (before reduction is $8,000. X receives in 1983 a $6,000 energ loan from the Department of Energy for this fa cility at a subsidized rate of interest. The quali fied investment for the energy property is re duced by $6,000 to $2,000. See paragrap (o)(5)(ii) of this section.

Example (2). Assume the same facts as in ex ample (1) except that the $6,000 is borrowe from a fund established by a local governme unit from the proceeds of exempt IDB's. Th qualified investment in the energy property is re duced by $4,800 (*i.e.*, $6,000 $8,000/$10,000). Thus, the qualified inve ment is reduced from $8,000 to $3,200. S paragraph (o)(5)(iii)(A) of this section.

Example (3). Assume the same facts as in e ample (1) except that the total $6,000 borrow to finance the property is from two sourc $2,000 is a subsidized energy loan and $4,000 attributable to the proceeds of exempt IDB First, the qualified investment in the ener property of $8,000 is reduced by the subsidiz energy loan of $2,000 to $6,000. For purposes allocating the proceeds from exempt IDB's, t numerator and denominator of the fraction example (2) are both reduced by this $2,0 from $8,000/$10,000 to $6,000/$8,000. Th the amount attributed to the proceeds of exem IDB's is $3,000 (*i.e.*, $4,000 x $6,000/$8,00 and the qualified investment for the ene property is $3,000, *i.e.*, $6,000 − $3,000. paragraph (o)(5)(iv) of this section.

Example (4). (a) In 1983, Corporation Y constructs a coal gasification project having an esti ed useful life of 20 years and consisting of a gasifier and air pollution control equipment. The cost of the project is $60 million, allocable to various types of property as follows:

($ 000,000 omitted)

	Gasifier	*Pollution control equipment*
Energy property	$30	$10
Other	10	10
	$40	$20

(b) Y finances construction of the project with subsidized financing ($10 million) and conventional financing ($36 million). Y also receives proceeds of $14 million from an issue of exempt IDB's, the exempt status of which is derived solely under section 103(b)(4)(F). Y uses the proceeds of the exempt IDB's solely to provide the pollution control equipment.

(c) Qualified investment for the energy credit is determined as follows:

	Energy property	
	Gasifier	*Pollution control equipment*
1. Cost	$30	$10
2. Allocation of subsidized energy financing ($10) to energy property		
(a) $10 x 30/40	7.5	
(b) $10 x 10/40		2.5
3. Remainder after applying paragraph (o)(5)(ii) of this section	$22.5	$ 7.5
4. Allocation of proceeds ($14) of IDB exempt solely under section 103(b)(4):		
(a) Fraction of cost of pollution control equipment that is energy property		10/20
(b) Reduce numerator and denominator of fraction by line 2(b)		7.5/17.5
(c) Multiply by proceeds		$14
(d) Allocated proceeds (line (b) x (c))		$ 6
5. Qualified investment for energy credit after applying paragraph (o)(5)(i)-(iv) of this section (line 3 − line 4(d))	$22.5	$ 1.5

(6) *One-half exempt IDB rule for certain periods*. For periods beginning on or after October 1, 1978, to which the general rule of paragraph (o)(2) of this section does not apply, the energy percentage for property is one-half of the energy percentage determine under section 46(a)(2)(C) if any funds borrowed to finance the facility of which the energy property is a part are directly or indirectly attributable to the proceeds of exempt IDB's. For explanation of the effective date of this subparagraph (6), see paragraph (o)(8) of this section.

(7) *Add-on equipment rule*. (i) Energy property is not considered to be financed with subsidized borrowings solely because it is installed in an existing facility which has been previously so financed.

(ii) The facts and circumstances determine if energy property installed in connection with existing property is a separate unit or installed pursuant to a design, plan, or as a component of a larger proprty (such as a project or facility).

(iii) The following example illustrates this subparagraph (7).

Example. In 1981, Corporation X finances its energy facility with the proceeds of exempt IDB's. The facility meets all air pollution laws and regulations in existence, or anticipated, when it is placed in service. In 1982, a new State regulation requires the installation of additional air pollution control equipment which is alternative energy property under section 48(l)(3)(A)(vi). X receives subsidized energy financing and installs the added equipment pursuant to the new regulation. The added air pollution control equipment is a separate unit. Therefore, the subsidized energy loan for the facility is not imputed to the qualified investment in this new separate unit.

(8) *Effective dates*. (i) The general rule in paragraph (o)(2) of this section applies to early application property for periods after December 31, 1979. Early application property is defined in paragraph (o)(9) of this section. For other property, it applies to periods after December 31, 1982.

(ii) Notwithstanding paragraph (o)(8)(i) of this section, funds attributable under paragraph (o)(4) of this section to subsidized energy financing made before January 1, 1980, shall not be taken into account for purposes of reducing qualified investment under the general rule of paragraph (o)(2) of this section. See section 223(c)(2)(D) of Pub. L. 96-223. Subsidized energy financing is considered made before January 1, 1980, if it meets the requirements of §1.167(j)-4(c) (applied without reference to any dates therein).

(iii) The one-half-exempt IDB rule in paragraph (o)(6) of this section applies for periods beginning after October 1, 1978, to which the general rule of paragraph (o)(2) of this section does not apply.

(iv) For purposes of this subparagraph (8), whether qualified investment (without any reduction under this paragraph (o)) falls within a period is determined under section 48(m). If under section 48(m) this qualified investment for energy property is allocable to more than one period, the portion of subsidized borrowings used to finance the property (as determined under paragraph (o)(5) of this section) is ratably apportioned to this qualified investment for each period in proportion to this qualified investment for each period.

(v) The following examples illustrate this subparagraph (8).

Example (1). (a) Corporation Z begins building on February 1, 1980, a facility costing $100,000, $75,000 of which is solar energy property which generates electricity. The energy property has a useful life of seven years. The facility is completed in 1983. Z spent $45,000 for the energy property for the period ending on December 31, 1982, and $30,000 for periods after that date. In connection with this facility, Z receives a loan of $10,000 attributable to subsidized energy financing made in January 1980.

(b) The subsidized energy financing is allocated between the two periods in proportion to the amount of basis of energy property attributable to each period. Thus, $6,000 of the subsidized financing is allocated to the period before 1983 (*i.e.*, $10,000 x $45,000/$75,000) and $4,000 is allocated to the period after 1982 (*i.e.*, $10,000 x $30,000/$75,000). See paragraph (o)(8)(iv) of this section.

(c) The $6,000 of subsidized energy financing attributable to the period before 1983 does not reduce qualified investment in energy property (other than early application property) because the general rule in paragraph (o)(2) of this section does not apply. However, the qualified investment of $30,000 for the period after 1982 is reduced by $4,000 to $26,000.

Example (2). Assume the same facts as in example (1) except that the energy property is early application property. The general rule in paragraph (o)(2) of this section applies and the total amount of subsidized energy financing ($10,000) is subtracted from the total qualified investment. Thus, the qualified investment for the energy credit is reduced from $75,000 to $65,000.

Example (3). (a) Assume the same facts as in example (1) except that the $10,000 loan was attributable to the proceeds of exempt IDB financing. Exempt IDB financing allocated to pre-1983 periods does not reduce the qualified investment. Instead, the energy percentage is reduced by one-half from 15 percent to 7½ percent and applied against the qualified investment allocable to such periods, *i.e.*, $45,000. See section 45(a)(2)(C).

(b) The amount of exempt IDB financing attributable to qualified investment in energy property is $7,500 (*i.e.*, $10,000 x $75,000/$100,000). The portion of that amount attributable to periods after 1982 is $3,000 (*i.e.*, $7,500 x $30,000/$75,000). Accordingly, the qualified investment for the energy property attributable to periods after 1982 is reduced from $30,000 by $3,000 to $27,000. See paragraph (o)(8)(iv) of this section.

Example (4). Assume the same facts in example (3) except that the energy property is early application property. The general rule in paragraph (o)(2) of this section applies to the entire energy property, and the total amount of the proceeds of exempt IDB's is multiplied by the fraction in paragraph (o)(5)(iii) of this section. Thus, the qualified investment of $75,000 is reduced by $7,500 (*i.e.*, $10,000 x $75,000/$100,000 to $67,500.)

(9) *Early application property.* (i) Early application property is—

(A) Qualified hydroelectric generating property (described in section 48(l)(2)(A)(vii)),

(B) Cogeneration equipment (described in section 48(l)(2)(A)(viii)),

(C) Qualified intercity buses (described in section 48(l)(2)(A)(ix)),

(D) Ocean thermal property (described in section 48(l)(3)(A)(ix)), or

(E) Expanded energy property.

(ii) Expanded energy property is—

(A) Property that is included for the first time as alternative energy property under clause (iii) or (v) of section 48(l)(3)(A) by reason of the amendments thereto by section 222(b)(1) and (2) of the Crude Oil Windfall Profit Tax Act of 1980 (Pub. L. 96-223, 94 Stat. 229),

(B) Solar or wind energy property that provides solar process heat referred to in section 48(l)(4)(C),

(C) Modifications to alumina electrolytic cells referred to in section 48(l)(5)(L), and

(D) Property described in the last sentence of section 48(l)(3)(A) (relating to storage equipment for refuse-derived fuel).

ROSCOE L. EGGER, JR.,
Commissioner of
Internal Revenue.

(Filed by the Office of the Federal Register on January 25, 1982, 8:45 a.m., and published in the issue of the Federal Register for January 26, 1982, 47 F.R. 3559)

Notice of Proposed Rulemaking

Definition of an Airport

LR-6-81

SUMMARY: This document contains proposed amendments to the regulations governing the treatment of industrial development bonds used to finance hotels located at or near airports. Issuers and purchasers of those bonds and owners of those facilities are affected.

DATE: Written comments and requests for a public hearing must be delivered by April 26, 1982. The amendments to the regulations generally are proposed to be effective with respect to governmental obligations issued after February 24, 1982. However, these amendments as they relate to the revocation of §1.103-8(e)(4) Example (3) as published in Treasury Decision 7737 [1981-1 C.B. 47, 50] are proposed to be effective with respect to obligations issued after 5:00 p.m. EST, December 29, 1978.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, 1111 Constitution Avenue, N.W. Washington, D.C. 20224, Attention: CC:LR:T (LR-6-81).

FOR FURTHER INFORMATION CONTACT: Susan K. Thompson of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3294).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to clarify the Income Tax Regulations (26 CFR Part 1) under section 103 of the Internal Revenue Code of 1954. These amendments to the regulations are proposed to be issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (26 U.S.C. 7805; 68A Stat. 917).

Final regulations under section 103(b)(4) were published in the FEDERAL REGISTER as Treasury Decision 7737 on November 17, 1980 (45 FR 75644). These regulations provided rules defining the term "airport". Interest on industrial development bonds generally is not includable in gross income if substantially all of the proceeds are used to provide an airport or a facility functionally related and subordinate to an airport. The final regulations published as T.D. 7737 contained an example specifically applying to hotels the criteria for determining whether a facility is functionally related and subordinate to an airport. The antecedent notice of proposed rulemaking had not contained this example. Commentary critical of this example has prompted a reconsideration of the policy underlying this example, and these proposed amendments to the regulations implement the results of this reconsideration.

EXPLANATION OF NEW PROVISIONS

Section 1.103-8(e)(4) is proposed to be amended by deleting Example (3) effective with respect to obligations issued after 5:00 p.m. EST, Decembe 29, 1978. Section 1.103-8(e)(2)(ii) i proposed to be amended by adding a new subdivision (*d*) illustrating the rules of paragraph (e)(2)(ii) as they apply to airport hotels. Under proposed §1.103-8(e)(2)(ii)(*d*), a hotel located at or adjacent to an airport is of a character and size commensurate with the character and size of the airport if the number of rooms in the hotel is reasonable given the current and projected passenger usage of the terminal facility. Such a hotel may contain meeting rooms if the number and size of these rooms is in reasonable proportion to the number and size of the guest rooms in the hotel. Two examples illustrating the application of these rules are also proposed by these amendments. These amendments are proposed to be effective on February 24, 1982.

Evaluation of the effectiveness of this regulation will be based on comments received from offices within the Treasury and Internal Revenue Service, other governmental agencies, and the public. These regulations will impose no new reporting or recordkeeping requirements.

DRAFTING INFORMATION

The principal author of this regulation is Susan K. Thompson of the Legislation and Regulations Division o the Office of the Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and the Treasur Department participated in developing the regulations, both substantivel and stylistically.

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 1 amended as follows:

Paragraph (e)(2)(ii) of §1.103-8 is amended by adding a new subdivision (*d*) immediately following subdivision (*c*), and paragraph (e)(4) is amended by deleting Example (3) and inserting new Examples (3) and (4) in its place. These added provisions read as follows:

§1.103-8 Interest on bonds to finance certain exempt facilities.

* * * * *

(e) *Certain transportation facilities.* ***

(2) *Definitions.* ***

(ii) ***

(*d*) A hotel located at or adjacent to an airport satisfies the requirements of paragraph (e)(2)(ii)(*b*), that is, it is of a character and size commensurate with the character and size of the airport at or adjacent to which it is located, if the number of guest rooms in the hotel is reasonable for the size of the airport, taking into account the current and projected passenger usage of the terminal facility. If the hotel contains meeting rooms, the number and size of these rooms must be in reasonable proportion to the number of guest rooms in the hotel. Limited recreational facilities will not prevent the hotel from being of a character and size commensurate with the character and size of the airport.

* * * * *

(4) *Examples.* ***

Example (3). On June 1, M Airport Authority, a political subdivision of State O, issues obligations, the proceeds of which are loaned to X Corporation, a nonexempt person. X uses the proceeds to construct a hotel adjacent to the main terminal building at M Airport. X will be unconditionally liable for repayment of the proposed obligations. The hotel will be used to provide temporary and overnight accommodations for airline passengers using M Airport. The number of rooms in the hotel is reasonable for an airport of M's size, taking into account the current and projected passenger usage of the terminal facility. In addition to guest rooms, the hotel will contain a restaurant, small retail stores (such as a gift shop and newsstand), and limited recreation facilities (such as a swimming pool). The hotel will also contain several multipurpose rooms suitable for use as meeting rooms. The number and size of these rooms will be in reasonable proportion to the number and size of the guest rooms in the hotel. Use of the guest rooms, restaurant and stores, recreational facilities, and meeting rooms by air passengers arriving at or departing from M airport will be incidental to the use of the hotel by air passengers for temporary and overnight accommodations. The hotel is of a character and size commensurate with the character and size of M Airport. Consequently, applying the provisions of §1.103-8(e)(2), the hotel is functionally related and subordinate to M Airport. The obligations are industrial development bonds. Section 103(b)(1) does not apply to the obligations, however, unless the provisions of section 103(b)(10) and §1.103-11 apply.

Example (4). On June 1, 1980, N Airport Authority, a political subdivision of State P, issues obligations, the proceeds of which are loaned to Y Corporation, a nonexempt person. Y uses the proceeds to construct a hotel adjacent to the main terminal building at N Airport. Y Corporation will be unconditionally liable for repayment of the proposed obligations. The hotel will contain extensive recreational facilities, including a large rooftop swimming pool, tennis courts, and a health club. In addition, facilities for conferences consisting of a ballroom-sized meeting room capable of being partitioned by movable panels and several smaller meeting rooms will be constructed. The number of rooms in the hotel will substantially exceed the number which is reasonable based on the current and projected passenger usage of the terminal facility. Because of the presence of extensive recreational and conference facilities, as well as the presence of an excessive number of rooms at the hotel, the hotel fails to be of a character and size commensurate with the character and size of N Airport. The result would be the same if the hotel did not have extensive recreational facilities. Consequently, the hotel is not functionally related and subordinate to N Airport under §1.103-8(e)(2). The obligations are industrial development bonds and interest thereon is not excluded from gross income by reason of subsection (a)(1) or (b)(4) of section 103.

* * * * *

ROSCOE L. EGGER, JR.,
Commissioner of
Internal Revenue.

(Filed by the Office of the Federal Register on February 19, 1982, 12:47 p.m., and published in the issue of the Federal Register for February 24, 1982, 47 F.R. 8029)

Notice of Proposed Rulemaking

Treatment of Certain Interests in Corporations as Stock or Indebtedness

LR-75-81

SUMMARY: This document contains proposed revisions to regulations relating to the treatment of certain interests in corporations as stock or indebtedness. The Tax Reform Act of 1969 [Pub. L. 91-172, 1969-3 C.B. 10] authorized the Secretary of the Treasury to prescribe the regulations that are proposed to be revised by this document. This document also contains proposed conforming regulations relating to the allocation of income and deductions among taxpayers and certain other matters. The regulations would affect corporations and their shareholders and creditors.

DATES: Written comments must be delivered or mailed by March 1, 1982. The regulations are proposed to apply to interests in corporations created after June 30, 1982.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-75-81). Washington, DC 20224.

FOR FURTHER INFORMATION CONTACT: Carolyn Swift of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC 20224. Attention: CC:LR:T (202-566-3458, not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

Section 385 of the Internal Revenue Code relates to the treatment of certain interests in corporations as stock or indebtedness. Final regulations under section 385 were filed with the FEDERAL REGISTER on December 29, 1980, and were published as T.D. 7747 in the FEDERAL REGISTER for Wednesday, December 31, 1980 (45 FR 86438) [1981-1 C.B. 141]. These regulations generally would have applied to certain interests in corporations created after April 30, 1981. However, at the invitation of the Treasury and Internal Revenue Service, a number of public comments on the final regulations were received after December 31, 1980. The comments recommended changes in several areas of those regulations. In order to give the Treasury and Internal Revenue Service sufficient time to fully examine these comments and determine whether changes should be made, the regulations were amended by a Treasury decision (published in the FEDERAL REGISTER as T.D. 7774 on May 1, 1981 (46 F.R. 24945; [1981-1 C.B. 168]) to apply to certain interests in corporations only if they were created after December 31, 1981.

Treasury and the Internal Revenue Service have now evaluated the comments received after publication of the regulations filed on December 29, 1980 (the "December 29 regulations"). In response to these comments, a number of changes have been made. In addition to these substantive changes, many minor conforming changes (for example, changes in cross-references) have been made. To facilitate making these changes, the December 29 regulations are being amended by T.D. 7801 [page 60, this Bulletin] to apply to certain interests in corporations only if they are created after June 20, 1982. The document making this change appears in the final rules of the FEDERAL REGISTER [January 5, 1982, 47 F.R. 141]. In this document, changes are being proposed as amendments to the December 29 regulations. It is anticipated that the regulations under section 385, as amended, will apply to certain interests in corporations created after June 30, 1982.

The more important of the changes made in response to the public comments are discussed below.

Section 1.385-0—Purpose and General Explanation

In order to aid taxpayers in getting an overview of the section 385 regulations, a general explanation of the regulations has been added. This explanation is intended to summarize the rules in a relatively nontechnical way and to point out where taxpayers may be outside the scope of the regulations or may be able to use various safe harbors. This new explanation is in addition to the summary of rules set forth in §1.385-2 which is a more technical explanation serving as a source of references to the body of the regulations.

Section 1.385-1—Effective Date and Scope

A number of comments raised questions about the application of the regulations in the international context. In order to provide Treasury and the Internal Revenue Service a further opportunity to study these questions, the proposed amendments will not apply to certain interests created in international transactions (see §1.385-1(b)(3)). However, it should be emphasized that this exclusion of certain interests created in international transactions is only an interim measure pending further study and that the issuance of regulations applicable to such interests is contemplated. The public is encouraged to submit comments on what the regulations under section 385 should provide with respect to international transactions.

Several comments asked about the application of the regulations to interests created by cooperatives. The proposed regulations provide specific rules governing their application to interests created by cooperatives (see §1.385-1(b)(2); §1.385-6(a)(2)(v) and (h)(6)(viii)).

The proposed amendments also contain a new provision coordinating the hybrid instrument provisions under section 385 with the new installment sales provisions under section 453. This provision replaces the provision on this subject in the temporary installment sales regulations, §15A.453-1(c)(8). Under the new provision, a hybrid instrument is outside the scope of the section 385 regulations if it is issued in exchange for property (other than money) and §1.385-6 (relating to proportionality) does not apply to the instrument (see §1.385-1(b)(4). In effect, if a hybrid instrument issued in exchange for property is not issued proportionately it will be treated as stock or debt under applicable principles of law outside the section 385 regulations. If a hybrid instrument is issued proportionately in exchange for property, it is treated as stock or debt under §1.385-6(d) (including, where applicable under new §1.385-6(d)(2), discussed below).

The December 29 regulations provided an exception to the effective date for instruments issued pursuant to a plan filed in a bankruptcy proceeding. To qualify for the exception, the instrument had to be issued pursuant to a plan of reorganization filed with the court on or before December 29, 1980, in a proceeding under the Federal bankruptcy laws (Title 11, U.S.C.) or under the Regional Rail Reorganization Act of 1973 [Pub. L. 93-236, 1974-1 C.B. 383]. One comment pointed out that this standard might be difficult to apply where the bankruptcy court ultimately adopted a plan which drew from several different plans filed with the court at different times. To eliminate this potential problem, under the proposed regulations, an instrument will qualify for this exception if it is issued pursuant to a plan of reorganization confirmed by the court in a proceeding under the Federal bankruptcy laws or under the Regional Rail Reorganization Act of 1973 and the proceeding is commenced on or before the date this notice of proposed rulemaking is filed with the Federal Register (see 1.385-1(a)(2)(i)) [December 30, 1981].

The December 29 regulations also provided an exception to the effective date for certain instruments issued pursuant to a pre-existing binding written contract. This exception has been updated and clarified. In particular, under the provision in the proposed amendments, the contract must specify all the material terms and conditions of the instrument. The purpose of this regulation is to prevent a sole shareholder, *e.g.*, from avoiding the effective date of the regulations by a pre-existing general commitment to provide funds to his or her corporation.

Section 1.385-2—Summary of Rules

Only conforming changes have been made in the summary of rules.

Section 1.385-3—Definition of Terms

A number of commenters expressed concern that the excessive or inadequate consideration rules (§1.385-3(a) of the December 29 regulations)—which applied to any instrument issued to a "shareholder"—might be applied to lenders owning relatively small amounts of stock or warrants. As a result, the interest rate on instruments issued to such lenders with small equity interests might have been adjusted through the application of §1.385-3(a) of the December 29 regulations in conjunction with section 1232 or §1.61-12(c)(2). Other commenters were unsure about how the excessive or inadequate consideration rules would apply to instruments issued to nonshareholders to whom stock ownership would customarily be attributed (*e.g.*, the spouse or children of a shareholder).

In order to clarify the regulations on these points, Treasury decided to apply the excessive or inadequate consideration rules only to proportionately-held instruments rather than to instruments issued to shareholders (see

§1.385-6(c)). It was felt that this change was in keeping with the overall focus of the regulations on proportionate debt because shareholders have no economic incentive to set or enforce arm's length terms on proportionate debt.

Three points should be clarified, however, in connection with this change. First, under the December 29 regulations, there were situations where nonproportionate debt was treated as being held proportionately (§1.385-6(a)(7) of the December 29 regulations). In general, these are situations where, because of compensating arrangements involving the other shareholders, a shareholder holding debt nonproportionately may not have an economic incentive to act like an independent creditor. For example, if a 50-percent shareholder who owns all of the corporation's debt agrees to forego $5,000 of interest as part of an arrangement where the other 50-percent shareholder agrees to forego a $5,000 salary payment due from the corporation, the first shareholder's debt will be treated as held proportionately.

These rules will continue to apply as part of the proposed regulations (see §1.385-6(a)(7)). Indeed, these rules will play an even more important role as a result of the restriction of the application of the excessive or inadequate consideration rules to proportionate debt.

Second, it is not intended that restricting the excessive or inadequate consideration rules to proportionate debt will affect the applicability under current law of section 301, section 1232 or the regulations thereunder to nonproportionate debt. For example, the investment unit rules of §1.1232-3(b)(2)(ii) will continue to apply to an investment unit consisting of an obligation and shares of stock even if the class of obligations is not held proportionately. See examples (7), (8), and (9) of §1.385-6(a)(6).

Third, it should be noted that the proposed amendments add a new provision which treats an instrument as if it were issued proportionately if (1) the instrument is held by a person who owns, actually or constructively, at least 25 percent of the value or voting power of the issuing corporation's stock and (2) the issuing corporation's debt-to-equity ratio, at the end of the year of issuance, exceeds 10:1. In effect, such an instrument (assuming it is a straight debt instrument) is subject to the independent creditor standard of §1.385-6(g)(2) and to the "second look" rules of §1.385-6(k), (l), and (m). The reason for this provision is that when a lender owns a substantial amount of a corporation's stock and lends to the corporation when it has a very high debt-to-equity ratio, Treasury felt that this was evidence that the lender was acting more like a stockholder than a creditor with respect to the debt instrument. Thus, it was felt that, under these circumstances, the burden should shift to the lender to demonstrate that it is acting as an independent creditor with respect to the debt instrument.

Two additional changes have been made in the excessive or inadequate consideration provisions. First, under the December 29 regulations, the excessive or inadequate consideration provisions applied to all instruments, whether they were treated as indebtedness or stock under the section 385 regulations. Under the proposed amendments, the excessive or inadequate consideration provisions apply only to instruments treated as indebtedness under the regulations. If an instrument is initially treated as stock under the section 385 regulations, then the treatment of the excess of the consideration paid for the instrument over its fair market value (or the excess of the instrument's fair market value over the consideration paid therefor) will be determined outside the section 385 regulations (see §1.385-6(c)(1), (2), and (3)).

Second, under the December 29 regulations, the excess of the consideration paid for an instrument over its fair market value was automatically treated as a capital contribution and the excess of the instrument's fair market value over the consideration paid therefor was automatically treated as a section 301 distribution. Under the proposed amendments, such excesses will *ordinarily* be treated, respectively, as a capital contribution and a section 301 distribution but, under appropriate circumstances, may be treated as a gift followed by a capital contribution, as a section 301 distribution followed by a gift, as compensation for services, or as otherwise determined under general principles of tax law.

There was a provision in the December 29 regulations which enabled the Commissioner to disregard a noncommercial term of an instrument, in determining the fair market value of the instrument or the reasonableness of an interest rate, if the principal purpose of the term was to increase or decrease the instrument's fair market value or a reasonable rate of interest for the instrument. One comment pointed out that, in some sense, the purpose of *any* term of an instrument may be to increase or decrease its fair market value. Accordingly, this provision has been clarified to enable the Commissioner to disregard a noncommercial term if its principal purpose is to increase or decrease the instrument's fair market value or a reasonable rate of interest for the instrument *for Federal tax purposes* (see §1.385-3(a)(1)(iii)).

Also, the example in this provision has been changed to make the sole shareholder an individual with large net operating loss carryovers rather than a nonresident alien. The only purpose of this change is to make the sole shareholder a U.S. person who would have an incentive to charge an above-market interest rate on a loan to the corporation. In view of the exclusion in connection with international transactions, all references to non-U.S. persons have been deleted. There is no significance to the fact that the shareholder has large net operating loss carryovers other than that it would give the shareholder an incentive to charge an above-market interest rate. See also example (3) of §1.385-6(h)(5).

Finally, with the transfer of the excessive or inadequate consideration provisions from §1.385-3 to §1.385-6, §1.385-3 has been reorganized and retitled "Definition of terms" instead of "Preliminary rules."

Section 1.385-4—Instruments Generally

Under §1.385-4(c)(1)(ii), if an instrument becomes stock under §1.385-

6(k), (l), or (m), then the instrument is treated as having been exchanged (without recognition of gain or loss) for preferred stock in a recapitalization to which section 368(a)(1)(E) applies. This provision has been clarified concerning its application to an instrument which is reclassified as preferred stock because of a change in terms. If the change in terms is sufficiently substantial so that the changes in terms is treated as an exchange of instruments under applicable principles of tax law (without reference to the section 385 regulations), then §1.385-4(c)(1)(ii) does not apply and the tax treatment of the constructive exchange is determined outside the section 385 regulations. However, if the change in terms is not treated as an exchange of instruments under applicable principles of the tax law, then §1.385-4(c)(1)(ii) applies.

Section 1.385-5—Certain Hybrid Instruments

Under the December 29 regulations, a hybrid instrument was treated as stock if, on the day of issue, the fair market value of the instrument without its equity features was less than 50 percent of the actual fair market value of the instrument (with those features). Several commenters were unsure about how to compute the fair market value of a hybrid instrument without its equity features.

In order to clarify the regulations on this point, the rules for determining whether a hybrid instrument should be treated as stock or indebtedness have been revised in the proposed amendments. Under §1.385-5, as revised, a hybrid instrument is treated as stock, if on the day of issue, the fair market value of the "straight debt payments" with respect to the instrument is less than 50 percent of the fair market value of the instrument (see §1.385-5(a)). The proposed amendments set forth a series of operating rules for determining these straight debt payments (see §1.385-5(d)). For example, to the extent a hybrid instrument provides for a contingent payment that is contingent in amount, the straight debt payments are computed assuming the occurrence of the contingency resulting in the smallest possible payment under the instrument. To the extent the hybrid instrument provides for a contingent payment that is contingent as to timing, the straight debt payments are computed assuming the occurrence of the contingency providing for payment on the latest possible date under the instrument.

In computing the fair market value of the straight debt payments with respect to a hybrid instrument, the present value of each of the straight debt payments must be computed. The proposed amendments provide additional guidance for arriving at a discount rate for this present value calculation. On this point, the proposed amendments provide that the discount rate to be used in computing the present value of a straight debt payment payable at a future date is a reasonable rate of interest (determined without regard to the safe harbor of §1.385-6(f)(2)) for an instrument in the amount of the straight debt payment payable on the date that the straight debt payment must be made and payable on the terms and conditions of such fixed payment (see §1.385-(d)(3)). An example illustrating this rule has also been added.

Also, the proposed amendments provide that, with respect to an instrument issued in a redemption of stock, the instrument will not be considered a hybrid instrument solely because amounts designated as principal or interest (or both) are, by operation of local law, payable only out of earned surplus (see §1.385-5(c)(5)(v) and example (12) of §1.385-5(f)). It should be emphasized that this provision applies only when the earned surplus restriction is imposed by state law and not when it arises by agreement of the parties.

In addition, in response to comments on this point, the proposed amendments clarify the circumstances under which a nonrecourse obligation will be considered a hybrid instrument (see §1.385-5(c)(5)(iv) and example (13) of §1.385-5(f)).

Finally, the definitions of "contingent payment" and related terms (fixed payments of interest, fixed payments of principal, and definitely ascertainable) have been retained from the December 29 regulations. The public is encouraged to submit comments on whether these definitions are satisfactory for the purpose of isolating "equity-like" payments (*e.g.*, in the case of bonds subject to extensive covenants).

Section 1.385-6—Proportionality

Several very important changes have been made in the provisions relating to proportionality.

Definition of proportionality. Many comments expressed the view that proportionality should be defined objectively. In view of the central role played by proportionality in the section 385 regulations, Treasury agrees that an objective definition for proportionality is appropriate.

Under a new provision in the proposed regulations, holdings of stock and a class of instruments will be considered substantially proportionate if the total overlap of ownership of stock and the class of instruments exceeds 50 percent (see 1.385-6(a)(2)). Thus, for example, if the sole shareholder of a corporation owns 50 percent of a class of instruments and an independent creditor owns the other 50 percent of the class of instruments, the holdings of the corporation's stock and the class of instruments are not substantially proportionate. However, if the sole shareholder owned more than 50 percent of the class of instruments, the holdings of the stock and the class of instruments would be substantially proportionate.

Similarly, if a 50 percent shareholder of a corporation owns 100 percent of a class of instruments, holdings of the corporation's stock and the class of instruments are not substantially proportionate. However, if a more-than-50-percent shareholder of a corporation owns 100 percent of a class of instruments, then holdings of the corporation's stock and the class of instruments are substantially proportionate.

In connection with this objective tes for proportionality, it should be emphasized that the fact that a class of instruments is proportionate does no mean that the instruments are automatically treated as stock. It mean only that the instruments are subjec to the more stringent tests of §1.385- in determining whether the instru ments are treated as stock or indebtedness.

The objective test for determining whether there is proportionality contains several additional rules:

(1) *Attribution rules.* With some important modifications, the attribution rules of section 318(a) apply to attribute the ownership of both stock and instruments (see §1.385-6(a)(2)(ii) and the examples in §1.385-6(a)(2)(vii)).

(2) *Definition of stock.* There is a definition of the term "stock" for purposes of determining proportionality (see §1.385-6(a)(2)(iii) and examples (7) and (12) of §1.385-6a(6)).

(3) *Special rule for certain redemptions.* There is a special rule for straight debt instruments issued proportionately in redemption of stock if section 302(a) would apply to the redemption (if the instrument were treated as indebtedness) and the section 483(c) interest rate is charged. Such instruments are initially treated as indebtedness and there is no adjustment of the interest rate under §1.385-6(c) and section 1232 or §1.61-12(c)(2); however, they are subject to the "second look" rules of §1.385-6(k), (l), and (m).

(4) *Rules for cooperatives.* There is a special rule for determining proportionality with respect to holdings in cooperatives (see §1.385-6(a)(2)(v)).

Safe harbor. The December 29 regulations provided a safe harbor for a straight debt instrument if, in general, (i) the debt-to-equity ratio of the issuing corporation did not exceed 1:1; (ii) the instrument had a fixed maturity and provided for annual payments of interest at the section 6621 rate, a local prime rate, a rate determined by the Secretary of the Treasury taking into account the yield on U.S. obligations of comparable maturity, or any rate in between; and (iii) all principal and interest were paid when due. Many commenters urged that the debt-to-equity requirement for the safe harbor should be increased and that additional safe harbor interest rates should be added.

The proposed amendments increase the debt-to-equity limit from 1:1 to 3:1 (see §1.385-6(f)(2)(ii)). In addition, they add as safe harbor interest rates the safe haven interest rates under section 482 (see §1.385-6(f)(2)(i)(A)). As a result, the section 385 regulations now contain an extremely broad safe harbor enabling most taxpayers to assure that significant amounts of proportionate straight debt will be treated as debt for tax purposes. This increased safe harbor should be particularly beneficial for small businesses.

The interest rate two points above the prime rate has also been added as a safe harbor interest rate. The purpose of this addition is to allow taxpayers the certainty and simplicity of the safe harbor even if they choose to charge an interest rate somewhat above the prime rate—a rate that may more closely resemble the rate at which the corporation could borrow from independent creditors.

Reasonable rate of interest. The general rule of §1.385-6(f)(1) provides that an interest rate on an instrument issued by a corporation is reasonable if it is within the normal range of rates paid to independent creditors on similar instruments by corporations of the same general size and in the same general industry, geographical location, and financial condition on the date the determination is made. This rule has been clarified to make explicit that the interest rate determined by the Secretary pursuant to §1.385-6(f)(2)(i)(A) for instruments of comparable maturity is a floor for the reasonable interest rate as determined under this general rule. Of course, higher rates may well be appropriate for this purpose. (The interest rate might be lower, however, if the safe harbor of §1.385-6(f)(2) is applicable).

Independent creditors. Several commenters requested that the regulations set forth the factors to be taken into account in determining whether a creditor will be considered an independent creditor for purposes of the regulations. Accordingly, the proposed amendments now set forth some of these factors (see §1.385-6(b)(1)).

In addition, the safe harbor requirements for classification as an independent creditor have been substantially revised (see §1.385-6(b)(2)-(4)).

Hybrid instruments issued proportionately. Under the December 29 regulations, a hybrid instrument was treated as stock if it was issued proportionately. Under the new proposed regulations, a class of hybrid instruments issued proportionately is not automatically treated as stock if, immediately after the class is issued, independent creditors (determined without regard to the "safe harbor" definition of independent creditor and without taking into account the creditor's holdings of the hybrid instruments at issue) own at least 20 percent of such class. In this case, the treatment of the hybrid instrument as debt or stock is determined under the general rule of §1.385-5. It should be emphasized, however, that, even if the class is treated as debt under §1.385-5, it remains subject (except for instruments held by independent creditors) to the "second look" rules of §1.385-6(k), (l), and (m).

Excessive debt. Under the December 29 regulations, a corporation's debt is considered "excessive" if (i) all of the instrument's terms and conditions and (ii) the corporation's financial structure, taken together, would not be satisfactory to a bank, insurance company or similar lending institution which makes ordinary commercial loans. (The taxpayer can avoid this test by meeting a safe harbor.) Under the proposed amendments, this rule is changed in one respect and is clarified in two additional respects (see §1.385-6(f)(2) and (6)). First, the proposed amendments require the transaction to be satisfactory to an independent creditor (determined without regard to the "safe harbor" definition of independent creditor) rather than just to a bank, insurance company or similar lending institution which makes ordinary commercial loans.

Second, the proposed amendments clarify that the stated interest rate is one of the "terms and conditions" of the instrument. Thus, if the interest rate would not be acceptable to an independent creditor, then the issuing corporation's debt is excessive (unless the safe harbor is met). However, the proposed amendments provide that an interest rate will be considered acceptable to an independent creditor for this purpose if a rate one point lower or one point higher would be acceptable to such creditor.

Third, the proposed amendments clarify that the instrument's terms and conditions (including the interest rate) are to be considered as a whole for purposes of this test. This means that slight nonmaterial deviations from particular terms or conditions that would be required by an independent creditor will not cause the instrument to fail this test if, considered as a whole, the terms and conditions would be acceptable to an independent creditor.

Debt-to-equity ratio. The debt-to-equity ratio of the issuing corporation is computed using the adjusted basis of the corporation's assets. For the reasons stated in the "Explanation of Changes" in the December 29 regulations (45 FR 86443), Treasury believes that, for the purposes of the section 385 regulations, adjusted basis of assets (and not fair market value) should be used in the debt-to-equity ratio computation. Accordingly, this rule is retained in the proposed regulations.

However, several commentators pointed out that, as a result of the new Accelerated Cost Recovery System ("ACRS") enacted as part of the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256], the adjusted basis of recovery property (within the meaning of section 168) will decline so rapidly that it will no longer be a sensible way to compute a corporation's equity in its assets. Treasury agrees that the adjusted basis of recovery property should not be used in computing debt-to-equity ratio. Moreover, it was felt that if a change were made in the method for computing adjusted basis for recovery property for purposes of computing debt-to-equity ratio, simple fairness dictated that a parallel change be made in making the calculation for older property that had been depreciated on an accelerated method. Accordingly, the proposed regulations compute the adjusted basis of property subject to an allowance for depreciation by computing depreciation deductions in the same manner as the adjustments to earnings and profits for depreciation under section 312(k) (see §1.385-6(h)(6)(i)). Thus, for example, under current section 312(k)(3), depreciation deductions for recovery property would be computed, in general, using the straight-line method with no salvage value and using a recovery period determined in accordance with the following table:

In the case of:	*The applicable recovery period is:*
3-year property	5 years
5-year property	12 years
10-year property	25 years
15-year real property	35 years
15-year public utility property	35 years

For depreciable property acquired before 1981 and depreciated using an accelerated method of depreciation, adjusted basis (for purposes of computing debt-to-equity ratio) would generally be computed using straight line depreciation.

The proposed amendments also provide a rule for computing the debt-to-equity ratio when the excessive or inadequate consideration provisions apply. Under this rule, the debt-to-equity ratio is computed before the excessive or inadequate consideration rules are applied (see §1.385-6(h)(4)). Thus, for example, if an instrument is issued bearing an unreasonably low interest rate and, as a result, a capital contribution would be imputed under §1.385-6(c), the debt-to-equity ratio of the issuing corporation is computed before imputation of the capital contribution.

The regulations provide special rules for computing the debt-to-equity ratio of an affiliated group of corporations. In the December 29 regulations, the term "affiliated group" was defined by reference to section 279(g). Under section 279(g), the term "affiliated group" has the same definition as in section 1504(a) except that (i) the exclusions of section 1504(b) are not applicable and (ii) the "acquired corporation" is not considered an includible corporation. The latter departure from the definition in section 1504(a) was inadvertent. Accordingly, §1.385-6(j)(1) has been modified to clarify that the definition of "affiliated group" for purposes of the regulations under section 385 shall be the same as in section 1504(a) except that no corporation shall be excluded from the group by the exclusions of section 1504(b).

Finally, an example has been added to clarify further the application of the rules for computing the debt-to-equity
ratio of an affiliated group of corpor
tions (see example (4) of §1.38
6(j)(2)).

Nonpayment of interest. In the D
cember 29 regulations, payment of i
terest with property other than mon
(*e.g.*, a note) was considered actu
payment to the extent of the fa
market value of the property. Und
the proposed amendments, payme
of interest with property other th
money is considered actual payment
the extent such property is includib
in the income of the holder of the i
strument (see §1.385-6(l)(3); §1.38
7(c)(2)). For this purpose, interest
considered includible in the income
a tax-exempt entity (*e.g.*, a charitab
organization) if it would be subject
tax if the entity were not tax-exempt.

Section 1.385-7—Certain Other Ob gations

Under the December 29 regulatio
there was an exception to §1.385-7
loans which were repaid within
months but only to the extent that
outstanding balance of such lo
(and demand instruments) did not
ceed $25,000. A number of comme
expressed the view that unwritt
loans in excess of $25,000 which w
repaid within a short period sho
also not be treated as capital contrib
tions merely because a reasonable
terest rate was not charged. Ot
comments noted that this provisi
might be burdensome for small bu
nesses.

Treasury agrees that an unwritt
loan which is actually repaid withi
short period (and not renewed or off
in some manner) should not be trea
as a capital contribution because
the failure to pay interest at a reas
able rate. Treasury also wanted to p
vide a rule that small businesses co
comply with. Accordingly, this exc
tion has been substantially expand
to exclude from §1.385-7 all loans (
gardless of amount) which are rep
within 120 days after the end of
taxable year in which the loan is m
(see §1.385-7(a)(2) and examples
and (4) of §1.385-7(e)).

By providing that the loan can
repaid within 120 days after the en
the taxable year in which the loa
made, this provision allows the

countant for a small corporate business, upon an annual review of the corporation's books, to advise the corporation to repay the loan before it is irrevocably classified as a contribution to capital. Although there is a strong policy to treat cash advances by shareholders as capital contributions where there is neither the observance of the requisite formality of a written instrument nor the payment of interest at a reasonable rate, it was felt that this policy could be mitigated to provide this practical solution for small businesses.

Treasury believes that at least some significant amount of interest should be paid with respect to these short-term loans, particularly in view of the extension in the permissible period of repayment from 6 months to as long as 16 months. It was felt, however, that an interest rate requirement (*e.g.*, a requirement that the loan be repaid with interest at the rates specified under section 482) would be a proverbial "trap for the unwary" for small businesses when noninterest bearing advances may be made for a few days. Accordingly, rather than treat all non-interest-bearing advances automatically as equity, Treasury decided that interest should be imputed at the section 482 rate as a condition for being able to use the exception for loans repaid within 120 days after the end of the taxable year of the loan. Therefore, the new rule provides that if a loan within the exception for loans repaid within 120 days after the end of the taxable year of the loan is not repaid with interest at an arm's length rate (within the meaning of §1.482-2(a)(2)), then interest at the rate set forth in §1.482-2(a)(2)(iii)(B)(2) shall be imputed.

In addition, there is a provision clarifying when a loan will be considered to be renewed or offset (and therefore not actually repaid) (see §1.385-7(a)(2)(iii)).

Section 1.385-8—Locked Interests

Only conforming changes have been made to §1.385-8.

Section 1.385-9 of the December 29 Regulations—Guaranteed Loans

Section 1.385-9 of the December 29 regulations, relating to guaranteed loans, has been omitted from the proposed regulations. The reason is to clarify—it is hoped beyond doubt—that the section 385 regulations are not intended to change existing case law relating to the circumstances under which a third party loan to a corporation which is guaranteed by a shareholder will be recharacterized as a loan to the shareholder followed by a capital contribution by the shareholder to the corporation. Thus, the existing case law, including such cases as *Plantation Patterns, Inc. v. Commissioner*, 462 F.2d 712 (5th Cir. 1972), cert. denied, 404 U.S. 1076 (1972), aff'g T C. Memo Dec. 1970-82 (1970), will continue to govern whether such recharacterization is appropriate.

Section 1.385-10 of the December 29 Regulations—Certain Preferred Stock

Section 1.385-10 of the December 29 regulations, relating to preferred stock, has been omitted from the proposed regulations. Accordingly, the existing case law will continue to govern whether a preferred stock bears a sufficient substantive resemblance to debt for it to be treated as debt for tax purposes.

Treasury and the Internal Revenue Service are continuing to study whether further guidance in this area should be provided to taxpayers. The public is thus encouraged to submit comments relating to this area.

Provision Relating to Section 171

If a corporation issues an instrument proportionately for its face amount and the interest rate on the instrument is unreasonably high, then the fair market value of the investment would exceed the consideration paid for the instrument. If the instrument is treated as indebtedness, this excess is treated as a section 301 distribution. In addition, the shareholder's basis for the instrument is increased by the amount of the section 301 distribution. See §1.301-1(j); §1.385-6(c)(3) example (5). As a result, the basis of the note would exceed the face amount of the note and the note would be considered to be issued at a premium. See section 171(b); §1.61-12(c)(2). The corporation would be required to amortize the premium, resulting in an effective reduction of its interest deduction with respect to the instrument. Correspondingly, it would generally be advantageous to the shareholder to elect to amortize the premium and thereby effectively reduce the amount of interest to be included in the shareholder's income.

However, the shareholder can amortize the premium only if an election has been made in accordance with §1.171-3. Under this section, the election must be made by claiming a deduction for bond premium on the return for the first taxable year to which the taxpayer wishes the election to apply. Thus, if a final determination that the instrument had been issued at a premium is not made until several years after the instrument is issued (*e.g.*, as a result of a settlement between the Service and the taxpayer or a final court decision), it may be too late to elect to amortize the premium for the year of issue and interim years.

To allow the shareholder the benefit of amortizing this premium for these years (to the extent such years are open years for the shareholder), the regulations under section 171 have been amended to provide that the election under section 171 shall (unless the taxpayer elects otherwise) be deemed to apply to these years (see new §1.171-3(d)).

INITIAL REGULATORY FLEXIBILITY ANALYSIS

The proposed amendments to the regulations under section 385 are being issued in response to the public comments on the December 29 regulations that have been received at Treasury's invitation and as a result of further study of the regulations by Treasury and the Internal Revenue Service. The objective of the proposed amendments is to provide further guidance on the treatment of certain interests in corporations as stock or indebtedness for Federal tax purposes. The proposed amendments are prescribed pursuant to authority granted in section 385 of the Internal Revenue Code.

The proposed amendments relate to the treatment of certain interests in corporations as stock or indebtedness. Thus, they have potential application to all small entities which are corporations, and to their shareholders and creditors.

The proposed amendments do not create new reporting, or recordkeeping, or other similar compliance requirements.

The proposed amendments do not duplicate, overlap or conflict with any existing Federal regulation.

The purpose of the regulations under section 385 is to replace the voluminous and uncertain case law with a set of rules that will enable taxpayers to plan their transactions with the knowledge of the likely treatment of certain interests as debt or equity for Federal tax purposes. It is not feasible to exempt small corporations from these rules because, as an examination of the case law will readily demonstrate, the principal problem addressed by the regulations—the extent to which proportionate debt should be treated as debt for Federal tax purposes—is a problem arising most often in the context of a small, closely held corporation.

However, the proposed amendments would make several changes which are particularly beneficial for small business. For example, the safe harbor provided by the December 29 regulations has been significantly expanded. The safe harbor under the December 29 regulations applied only if the issuing corporation's debt-to-equity ratio was 1:1 or less and certain specified interest rates were charged. Under the proposed amendments, the boundary of the safe harbor has been expanded to 3:1. Also, several additional safe harbor interest rates have been added—most notably the safe haven rates under section 482. The existence of a broad safe harbor is of particular significance to small businesses.

As another example, a general, nontechnical explanation of the regulations has been added. This will also be of particular benefit to small businesses.

The proposed amendments fall into two main categories:

(1) Proposed changes that would liberalize the December 29 regulations (*e.g.*, broadening of the safe harbor); and

(2) Proposed changes that would replace subjective rules with objective rules (*e.g.*, definition of proportionality).

Since, as explained above, it is not feasible to exempt small entities from the section 385 regulations, the main alternatives considered were making particular rules more or less liberal (*e.g.*, making the safe harbor debt-to-equity ratio either greater or less than 3:1) and leaving particular rules subjective rather than objective. As to the first type of alternative, it was concluded that the rules ultimately proposed struck an appropriate balance between preventing abuses in the debt-equity area and providing workable rules for small business. As to the second type of change, it was decided that, in the situations where objective rules were proposed, the advantage of objective rules in providing certainty outweighed the disadvantage of not providing the theoretically correct outcome in every case.

The actual changes are discussed in greater detail in the balance of the preamble.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING: Before these proposed regulations are adopted, consideration will be given to any written comments that are submitted (preferably six copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing has been scheduled and will be held on March 10, 1982. Notice of the time and place of this hearing appeared in Announcement 82-19, 1982-6 I.R.B. 38.

DRAFTING INFORMATION: The principal author of these proposed regulations is Carolyn Swift of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

PROPOSED AMENDMENTS TO THE REGULATIONS: The proposed amendments to 26 CFR Part 1 are as follows:

Paragraph 1. Section 1.166-9(c) is amended by deleting "(see §1.385-9)" from subparagraph (1).

Par. 2. Section 1.171-3 is amended by adding the phrase "except as provided in paragraph (d) of this section" at the end of the fourth sentence of paragraph (a) and by adding paragraph (d) to read as follows:

§1.171-3 Election with respect to taxable and partially taxable bonds.

* * * * *

(d) *Coordination with regulations under section 385*. If a corporation issues an instrument (as defined in §1.385-3(b)) to a taxpayer and

(1) The election described in paragraph (a) of this section is not otherwise in effect with respect to the instrument for one or more of the taxable years during which the instrument is outstanding; and

(2) As a result of a determination (as defined in section 1313(a)) with respect to the taxpayer, the instrument is found to have been issued at a premium pursuant to §1.385-6(c)(2) (see also example (5) of §1.385-6(c)(4) and section 171(b)), then such election shall be deemed to have been made with respect to the instrument as of the taxpayer's first open taxable year during which the instrument is outstanding. Such deemed election shall apply only to such instrument. The rules set forth in paragraph (a) of this section shall remain applicable to any other bonds owned by such taxpayer. Such deemed election shall not apply with respect to an instrument if, within 120 days of the determination described in paragraph (d)(2) of this section, the taxpayer files a statement to this effect with the Internal Revenue Service Center at which the taxpayer is required to file its return.

Par. 3. Sections 1.385-1 through 1.385-10 are amended by deleting §§1.385-9 and 1.385-10, by adding §1.385-0, and by revising §1.385- through §1.385-8. The added and revised sections read as follows:

§1.385-0 Purpose and general explanation.

(a) *Purpose*. Section 385(a) authorizes the promulgation of regulations to determine whether the creation of an interest in a corporation results in a debtor-creditor or corporation-shareholder relationship. Section 385(a) contemplates regulations that will determine not only when an interest in a corporation that is labeled debt will be treated as debt for tax purposes but also when such an interest will be treated as stock. However, not every interest in every corporation is subject to the regulations under section 385 because section 385(a) authorizes regulations only as they may be necessary or appropriate.

(b) *Focus of regulations; initial inquiries*—(1) *Instruments*. Under the section 385 regulations, certain interests in a corporation are characterized as stock or indebtedness immediately after the interest is created. If, under local law, an interest in a corporation is treated as indebtedness and if the interest is evidenced by a writing such as a bond, note or debenture, the writing is called an "instrument." Unwritten loans and loans not evidenced by an instrument (*e.g.*, appearing on a corporation's books or in a board of directors' resolution) are distinguished from instruments and may be treated differently under the section 385 regulations.

(2) *Straight debt instruments and hybrid instruments*. The section 385 regulations distinguish between straight debt instruments and hybrid instruments. Instruments that are either convertible into stock or provide for any contingent payment are "hybrid instruments." (For redemptions, earned surplus limitations imposed by local law do not cause a payment to be contingent). All other instruments are "straight debt instruments."

(3) *Proportionality*. The section 385 regulations focus on instruments that are held in substantially the same proportions as the corporation's stock. Generally, proportionality is considered to exist when there is a greater than 50 percent overlap between the ownership of stock and the class of instruments being characterized under these regulations. For this purpose, holdings of certain persons (*e.g.*, family members) may be aggregated under attribution rules.

(c) *Operation of regulations; no proportionality*.—(1) *Straight debt instruments*. Straight debt instruments not issued proportionately are ordinarily treated as indebtedness under the regulations. However, if an instrument is issued to a 25 percent shareholder and the corporation's debt-to-equity ratio exceeds 10:1, then the instrument is treated as if it were issued proportionately.

(2) *Hybrid instruments*. Hybrid instruments not issued proportionately are generally treated as indebtedness if the present value of straight debt payments with respect to the instrument is at least half of the fair market value of the instrument. However, if a hybrid instrument is issued nonproportionately in exchange for property (*e.g.*, a sale of a business to a corporation unrelated to the seller in exchange for a note providing for payments contingent on the profits of the business), the instrument is outside the scope of the section 385 regulations.

(d) *Operation of regulations; proportionality*.—(1) *Straight debt instruments*. The following rules apply to straight debt instruments issued proportionately:

(i) *Ratio not exceeding 3:1*. If the issuing corporation's debt-to-equity ratio does not exceed 3:1, then the instrument may qualify for the safe harbor described below in paragraph (d)(2)(iv) of this section.

(ii) *Inside ratio not exceeding 3:1 and outside ratio not exceeding 10:1*. If the issuing corporation's debt-to-equity ratio exceeds 3:1 (or the safe harbor is otherwise not satisfied) but the corporation's inside debt-to-equity ratio (excluding liabilities held by independent creditors) does not exceed 3:1 and its outside debt-to-equity ratio (including such liabilities) does not exceed 10:1, then:

(A) The instrument is treated as indebtedness;

(B) If the stated rate on the instrument is not reasonable this interest rate may, in effect, be adjusted to a reasonable rate. In general, this is done by treating an instrument as issued for an amount equal to its fair market value (rather than the amount purportedly paid for the instrument) and then applying the original issue discount or bond premium provisions; and

(C) The instrument, even though initially classified as indebtedness, may subsequently be reclassified as stock under the "second look" rules. Under these "second look" rules, an instrument may be reclassified as stock if there is a failure to pay interest or principal when due, there is a change in terms, or interest on a demand instrument is not paid at a reasonable rate.

(iii) *Inside ratio exceeds 3:1 or outside ratio exceeds 10:1*. If the issuing corporation's inside debt-to-equity ratio exceeds 3:1 or its outside debt-to-equity ratio exceeds 10:1, then the interest rate is not adjusted and the instrument is classified as stock unless the terms and conditions of the instrument coupled with the issuing corporation's financial structure would have been acceptable to an independent creditor (determined without regard to the independent creditor "safe harbor"). Even if the instrument is treated as indebtedness under this test, the instrument may subsequently be reclassified as stock under the "second look" rules described above in paragraph (d)(2)(ii)(C) of this section.

(iv) *Safe harbor*. In general, the regulations under section 385 provide a safe harbor for a straight debt instrument issued by a corporation for its face amount whenever all of the following conditions are satisfied:

(A) *Principal and interest*. The instrument has a fixed maturity date and provides for annual payments of interest at (1) the rate in effect under section 6621, (2) the prime rate in effect at any local commercial bank (or the rate two points above such rate), (3) a rate determined from time to time by the Secretary taking into consideration the average yield on outstanding marketable obligations of the United States of comparable maturity, (4) the endpoints of the range of rates set forth in §1.482-2(a)(2)(iii)(B)(1), or (5) any rate in between.

(B) *Debt-to-equity*. The debt-to-equity ratio of the corporation does not exceed 3:1.

(C) *Paid when due*. All principal and interest on the instrument are paid when due.

If a straight debt instrument falls within the safe harbor, then it will be treated as indebtedness when issued, the interest rate will not be adjusted through the imputation of original issue discount or bond premium, and (assuming its terms are not changed) it will not be subsequently reclassified as stock.

(2) *Absolute safe harbor for independent creditors*. Even if a class of straight debt instruments is issued proportionately, if one (or more) of the instruments in the class is issued to an independent creditor, the instrument will be treated as indebtedness and the interest rate will not be adjusted through the imputation of original issue discount or bond premium.

(3) *Hybrid instruments*. A hybrid instrument issued proportionately is generally treated as stock. However, if a class of hybrid instruments is issued proportionately but at least 20 percent of the class is owned by independent creditors (determined without regard to the independent creditor "safe harbor"), then the class of hybrid instruments is not automatically treated as stock; rather, the instruments will initially be treated as stock only if the present value of the straight debt payments with respect to the instruments is less than 50 percent of the fair market value of the instruments. The "second look" rules will also apply to the instruments not held by independent creditors.

(4) *Special rule for redemptions*. If a shareholder receives a proportionately-issued straight debt instrument in a redemption that would qualify for non-dividend treatment under section 302 if the instrument were treated as debt, the regulations under section 385 initially treat the straight debt instrument as indebtedness, subject to subsequent application of the "second look" rules. For redemptions only, earned surplus limitations imposed by local law do not affect the treatment of an instrument as a straight debt instrument.

(e) *Cross reference*. See 1.385-2 for a more detailed, technical summary of the regulations under section 385.

(f) *Cautionary note*. This section is merely a summary of the regulations under section 385 and is subject to all respects to the more complete rules contained in §1.385-1 and §§1.385-3 through 1.385-8.

§1.385-1 Stock or indebtedness.

(a) *Effective date*—(1) *In general*. The regulations under section 385 apply to instruments (as defined in §1.385-3(b)) issued after June 30, 1982 and to loans described in §1.385-7 made after June 30, 1982.

(2) *Exceptions*. The regulations under section 385 do not apply to—

(i) Instruments issued pursuant to a plan of reorganization confirmed by the court in a proceeding under the Federal bankruptcy laws (Title 11, U.S.C.) or under the Regional Rail Reorganization Act of 1973, if the proceeding is commenced on or before December 30, 1981, or

(ii) Instruments issued pursuant to a written contract which specifies all the material terms and conditions of the instrument and which is binding on December 30, 1981 and at all times thereafter, provided that the lender does not have an option not to acquire the instrument.

(b) *Scope*—(1) *In general*. The regulations under section 385 contain rules under which certain interests in corporations are treated as stock or indebtedness. All other interests (such as bank deposits, insurance policies, claims for wages, and trade accounts payable) are outside the scope of the regulations.

(2) *Cooperatives*. The regulations under section 385 apply to cooperatives described in section 1381(a). However, interests that constitute written notices of allocation under 1388(b), per-unit retain certificates under section 1388(g), or membership paper are outside the scope of the regulations under 385. For purposes of the regulations under section 385, "membership paper" means any evidence of a fee (payable in cash or other property) charged to a member or a patron for participation in the cooperative regardless of whether the fee is to be paid once or periodically or whether the fee is returnable in whole
or part. See §1.385-6(a)(2)(v) for
characterization of the interests
scribed in this subparagraph for
poses of determining proportion
of holdings in a cooperative.
§1.385-6(h)(6)(viii) for the chara
ization of these interests in compu
the debt-to-equity ratio of a coop
tive.

(3) *International transacti*
Until such time as further regulat
relating to the application of the
tion 385 regulations to internati
transactions are issued, any in
ment issued in an international tr
action or any loan described in §1.
7 made in an international transa
is outside the scope of the section
regulations. For purposes of the
ceding sentence, an instrument or
described in §1.385-7 is issued or n
in an international transaction if
an instrument issued by or to,
loan described in §1.385-7 made
by, (i) a person that is not a U
States person or (ii) a domestic co
ration dividends from which a
would be treated under se
861(a)(2)(A) as income from so
without the United States.

(4) *Certain hybrid instrumen*
sued for property. A hybrid in
ment (as defined in §1.385-3(d
outside the scope of the regula
under section 385 if it is issued i
change for property (other
money) and §1.385-6 (relating to
portionality) does not apply to suc
strument. For purposes of this
graph (a)(4), §1.385-6 will be
sidered to apply to an instrume
but for the exception provide
§1.385-6(d)(2), §1.385-6(d)(1)
apply to such instrument.

(5) *Consequences if outside s*
Any interest outside the scope o
regulations under section 385 w
treated as stock or indebtedness
applicable principles of law wi
reference to the regulations unde
tion 385.

(6) *Similar distinctions*. C
other sections of the Internal Re
Code make distinctions that are
lar to (but not the same as) the o
tween stock and indebtedness. S
385 does not necessarily govern
distinctions. Thus, for example,
terest in an organization m

treated as indebtedness under section 385, but the net profits of the organization may, by reason of the indebtedness, inure to the benefit of the holder within the meaning of section 501(c). Similarly, section 385 does not affect the availability of the investment tax credit with respect to a loan treated as an ownership interest within the meaning of section 48(k)(1)(C) (relating to the investment credit for movies). See §1.48-8(a)(4)(iii).

(c) *Authority*. Sections 1.385-1 through 1.385-8 are prescribed under the authority of section 385. In addition, certain provisions in these sections derive additional authority under section 7805, because they interpret other sections of the Internal Revenue Code, including section 301 (relating to distributions of property), section 1012 (relating to basis), and section 1232 (relating to original issue discount).

§1.385-2 Summary.

(a) *Instruments issued proportionately*—(1) *Straight debt instruments.* Straight debt instruments (as defined in §1.385-3(e)) issued proportionately to the issuing corporation's shareholders are ordinarily treated as indebtedness. Exceptions may apply where the issuing corporation has excessive debt (see §1.385-6(g)), or where the instruments are not issued for money, (see §1.385-6(e)) or are payable on demand (see §1.385-6(m)). Additionally, straight debt instruments initially treated as debt may be reclassified as stock where there is a failure to pay interest or principal when due (see §1.385-6(l) and (m)(3)) or where there is a change in terms (see §1.385-6(k)).

(2) *Hybrid instruments.* Hybrid instruments (*e.g.*, income bonds or convertible debentures) are generally treated as stock if they are issued proportionately (see §1.385-6(d)). There is an exception, however, if at least 20 percent of the class of hybrid instruments is held by independent creditors (determined without regard to the independent creditor safe harbor) (see §1.385-6(d)(2)).

(b) *Instruments not issued proportionately*—(1) *Straight debt instruments.* Straight debt instruments not issued proportionately are ordinarily treated as indebtedness. However, if an instrument is issued to a 25 percent shareholder and the corporation's debt-to-equity ratio exceeds 10:1, then the instrument is treated as if it were issued proportionately (see §1.385-6(a)(2)(vi).

(2) *Hybrid instruments.* Hybrid instruments not issued proportionately are generally treated as stock if the value of the straight debt payments with respect to the instrument is less than half of the fair market value of the instrument (see §1.385-5). Otherwise, they are generally treated in the same manner as straight debt instruments.

(c) *Ancillary rules*—(1) *In general.* In addition to the primary rules described in paragraphs (a) and (b) of this section, the regulations under section 385 also contain a variety of significant ancillary rules. These rules are subordinate in the sense that they do not apply directly to treat any interest as stock or indebtedness. However, they are essential to the working of the regulations.

(2) *Proportionality.* Section 1.385-6(a)(2) defines when holdings of a corporation's stock and a class of instruments are substantially proportionate. This definition is significant—

(i) When instruments are issued for excessive or inadequate consideration (see §1.385-6(c));

(ii) When hybrid instruments are issued (see §1.385-6(d));

(iii) When instruments are issued other than in consideration for money (see §1.385-6(e));

(iv) When an instrument is issued by a corporation with excessive debt (see §1.385-6(g));

(v) When there is a change in an instrument's terms (see §1.385-6(k));

(vi) When there is nonpayment of interest on an instrument (see §1.385-6(l));

(vii) When an instrument is payable on demand (see §1.385-6(m)).

(3) *Adjustment of interest rate.* If instruments issued proportionately are treated as indebtedness but do not carry a reasonable rate of interest, §1.385-6(c) provides a mechanism to adjust the rate to a reasonable rate by comparing the fair market value of the instrument with the cash consideration paid for it. If there is a difference between the value of the instrument and the cash consideration paid therefor, the amount deemed to be paid for the instrument is adjusted and this ordinarily results in the creation of either original issue discount (see section 1232) or amortizable bond premium (see section 171(b)). This result ensures that the holders take a reasonable amount into income as interest received, and that the issuing corporation takes a reasonable deduction for interest paid on the instruments each year (see §1.61-12(c)(2)).

(4) *Reasonable rate of interest.* Section 1.385-6(f) contains rules for determining whether a rate of interest is reasonable. These rules are significant—

(i) Where instruments are issued proportionately other than in exchange for money (see §1.385-6(e));

(ii) Where instruments are held proportionately and there is a change in terms (see §1.385-6(k)) or nonpayment of principal (see §1.385-6(l)(3));

(iii) Where instruments held proportionately are payable on demand (see §1.385-6(m));

(iv) Where loans of money made to a corporation by persons other than independent creditors are not evidenced by an instrument (see §1.385-7); and

(v) In determining the fair market value of an instrument (see §1.385-3(a)(2)).

(5) *Debt-to-equity ratio.* Paragraphs (h) and (j) of §1.385-6 contain rules for determining a corporation's debt-to-equity ratio. These rules are significant in determining—

(i) Whether a rate of interest is presumptively reasonable (see §1.385-6(f)(2)); and

(ii) Whether a corporation has excessive debt (see §1.385-6(g)).

(6) *Fair market value.* Section 1.385-3(a) contains rules for determining the fair market value of an instrument. These rules are significant in determining—

(i) Whether the interest rate will in effect be adjusted under §1.385-6(c) (and section 1232 or §1.61-12(c)(2)); and

(ii) Whether a hybrid instrument is treated as stock (see §1.385-5).

(d) *Safe harbor.* In general, the regulations under section 385 provide a safe harbor for a straight debt instrument (as defined in §1.385-3(e)) issued by a corporation for its face amount whenever all of the following conditions are satisfied:

(1) *Principal and interest.* The instrument has a fixed maturity date and provides for annual payments of interest at (i) the rate in effect under section 6621, (ii) the prime rate in effect at any local commercial bank (or a rate two points above such rate), (iii) a rate determined from time to time by the Secretary taking into consideration the average yield on outstanding marketable obligations of the United States of comparable maturity, (iv) either of the endpoints of the range of rates set forth in §1.482-2(a)(2)(iii)(B)(1), or (v) any rate in between.

(2) *Debt-to-equity ratio.* The debt-to-equity ratio of the corporation does not exceed 3:1.

(3) *Paid when due.* All principal and interest on the instrument are paid when due.

If a straight debt instrument falls within the safe harbor, then it will be treated as indebtedness when issued, no original issue discount or bond premium will be imputed with respect to it and (assuming its terms are not changed) it will not be subsequently reclassified as stock.

(e) *Other provisions*—(1) *Certain other loans.* Section 1.385-7 contains rules that apply to certain loans of money made to a corporation by persons other than independent creditors that are not evidenced by an instrument within 120 days after the end of the taxable year in which they are made.

(2) *Locked interests.* Section 1.385-8 contains rules that treat locked interests (such as a bond with a nondetachable warrant) as separate and distinct.

(f) *Cautionary note.* This section is merely a summary of the regulations under section 385, and is subject in all respects to the more complete rules contained in §§1.385-3 through 1.385-8.

§1.385-3 Definition of terms.

(a) *Fair market value.* The following rules apply for purposes of the regulations under section 385:

(1) *In general.* (i) The fair market value of an instrument is the price at which it would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of all relevant facts.

(ii) The fair market value of an instrument may be determined by using present value and standard bond tables. See §1.1232-3(b)(2)(ii)(*d*) for examples in which the fair market values of instruments are determined by the use of these tables.

(iii)(A) In determining the fair market value of an instrument (or the reasonableness of an interest rate), the Commissioner may disregard a noncommercial term of the instrument if the principal purpose of the inclusion of the term is to increase or decrease the fair market value of the instrument (or a reasonable rate of interest for the instrument) for Federal tax purposes. See also section 482.

(B) The following example illustrates the application of this subdivision (iii):

Example. A, an individual with large net operating loss carryovers, is the sole shareholder of corporation W. On January 1, 1987, W issues a $100,000, 28-percent debenture to *A* in exchange for $100,000. Under provision P of the debenture, an action to enforce the terms of the debenture can be maintained only in the village court of village V, located in foreign country Q. Assume that the principal purpose of the inclusion of provision P is to reduce the fair market value of the debenture for Federal tax purposes. Based on these facts, provision P will be disregarded in determining the fair market value of the debenture.

(2) *Rules of convenience.* (i) On the day of issue, the fair market value of a straight debt instrument is considered to be equal to the face amount if—

(A) The stated annual rate of interest on the instrument is reasonable (within the meaning of §1.385-6(f)), and

(B) The consideration paid for the instrument is equal to the face amount.

(ii) Notwithstanding any other provision of this paragraph (a), if an instrument is registered with the Securities and Exchange Commission and sold to the public for money, then the fair market value of the instrument on the day of issue is the issue price (as defined in section 1232(b)(2)).

(3) *Examples.* The following examples illustrate the application of paragraph (a)(2) of this section:

Example (1). On March 1, 1985, corporation M issues a $1,000, 8-percent, 5-year note at par. Assume that on that date, 10 to 12 percent is the range of rates of interest paid to independent creditors on similar instruments issued by corporations of the same general size and in the same general industry, geographic location, and financial condition; that the rate of interest in effect under section 6621 is 6 percent; that the interest rate for 5-year obligations determined by the Secretary pursuant to §1.385-6(f)(2)(i) is 7 percent; that the lowest prime rate at any local commercial bank is 9 percent; and that the range of rates set forth in §1.482-2(a)(2)(iii)(B)(1) is 8-10 percent. Also assume that M's debt-to-equity ratio at the end of the taxable year is 3:2. Based on these facts, any rate between 6 and 12 percent is a reasonable rate of interest within the meaning of §1.385-6(f). In particular, 8 percent is a reasonable rate of interest, and the fair market value of the note is therefore considered to be $1,000.

Example (2). The facts are the same as in example (1) except that M's debt-to-equity ratio at the end of the taxable year is 4:1. Based on these facts, paragraph (a)(2)(i) of this section does not apply.

Example (3). The facts are the same as in example (2) except that the note provides for annual payments of interest at a rate of 11 percent. Since 11 percent is within the range of rates of interest paid to independent creditors on similar instruments issued by corporations of the same general size and in the same general industry, geographic location and financial condition, the fair market value of the note is considered to be $1,000.

(b) *Instrument.* The term "instrument" means any bond, note, debenture, or similar written evidence of an obligation.

(c) *Obligation.* The term "obligation" means an interest in a corporation that is treated as indebtedness under applicable nontax law.

(d) *Hybrid instrument.* The term "hybrid instrument" means an instrument that is convertible into stock o one (such as an income bond or a participating bond) that provides for any contingent payment to the holde (other than a call premium).

(e) *Straight debt instrument.* Th term "straight debt instrument" mean any instrument other than a hybrid in strument.

(f) *Table of terms.* The followin table indicates where some other im portant terms referred to in the sectio 385 regulations are defined.

Subject	*§1.385-*
Contingent payment	5(d)(1)
Debt-to-equity ratio	6(h)
Excessive debt	6(g)(2)
Failure to pay interest	6(l)(3)
Fixed payments; interest	5(d)(2)
Fixed payments; principal	5(d)(3)
Independent creditor	6(b)
Reasonable rate of interest	6(f)

§1.385-4 Instruments generally.

(a) *General rule.* Except as otherwise provided in the regulations under section 385, all instruments (as defined in §1.385-3(b)) are treated as indebtedness for all purposes of the Internal Revenue Code. For exceptions, see §1.385-5 (relating to certain hybrid instruments) and §1.385-6 (relating to proportionality).

(b) *Operating rules*—(1) *In general.* The regulations under section 385 determine the status of each instrument (*i.e.*, as stock or indebtedness) at the time the instrument is issued. Except as provided in paragraphs (k), (l), and (m) of §1.385-6 (relating to proportionality), the status of an instrument can never change. Thus, for example, the status of an instrument is not affected by a mere change in ownership.

(2) *Special rule.* Under §1.385-6(k), (l), and (m), the status of an instrument can change from indebtedness to stock (*e.g.*, in the event of a failure to pay interest when due).

(c) *Effect of classification*—(1) *In general.* (i) If an instrument is treated as stock under section 385, then the instrument is treated as preferred stock for all purposes of the Internal Revenue Code. In particular, all payments of "interest" on the instrument are treated as distributions to which section 301 applies, and all payments of "principal" are treated as distributions in redemption of stock. Such preferred stock is considered to have the same terms (*e.g.* voting rights) as the instrument has under applicable local law. Each class of instruments classified as preferred stock is treated as a separate class of preferred stock. (See, however, §1.1371-1(h) for the effect on an election made under Subchapter S. Also see §1.992-1(d)(2) for an exception to this rule.)

(ii) If an instrument becomes stock under §1.385-6(k), (l), or (m), then the instrument is treated as having been exchanged (without recognition of gain or loss) for preferred stock in a recapitalization to which section 368(a)(1)(E) applies. For this purpose, if there is a change in the terms of an instrument and the change in terms is sufficiently substantial to be considered an exchange of instruments under applicable principles of tax law (ascertained without reference to the regulations under section 385), then the change in terms is treated under §1.385-6(e) (relating to instruments issued for property) rather than under §1.385-6(k) (relating to changes in terms). Thus, in the situation described in the preceding sentence, the tax consequences of the constructive exchange are determined without regard to the regulations under section 385 rather than under the first sentence of this paragraph (c)(1)(ii).

(2) *Illustrations.* The following examples illustrate the application of this paragraph (c):

Example (1). On January 1, 1983, corporation X issues a $100,000 note to A. The note is due on January 1, 1993, and pays interest at a rate of 10 percent a year. Assume that the note is initially treated as indebtedness under paragraph (a) of this section. However, on January 1, 1987, the note becomes stock under §1.385-6(l) (relating to nonpayment of interest). A is treated as having exchanged the note for preferred stock on January 1, 1987, in a recapitalization to which section 368(a)(1)(E) applies. Moreover, A does not recognize gain or loss merely because the note is reclassified.

Example (2). The facts are the same as in example (1). In addition, on July 1, 1988, A receives $15,000 in interest on the note. The entire $15,000 payment is treated as a distribution to which section 301 applies.

Example (3). Individuals B and C each own 50 percent of the stock of corporation Y. On January 1, 1990, Y distributes one convertible debenture each to B and C as a dividend. The convertible debentures are treated as stock under §1.385-6(d) (relating to hybrid instruments). Assume that Y has accumulated earnings and profits of $5 million at the time of the distribution. Based on these facts, the debentures are treated as section 306 stock unless their distribution is taxable under section 305(b)(5).

§1.385-5 Certain hybrid instruments.

(a) *In general.* A hybrid instrument is treated as stock if, on the day of issue—

(1) The fair market value of the straight debt payments (as defined in paragraph (d)(2) of this section) with respect to the instrument is less than

(2) Fifty percent of the fair market value of the instrument.

(b) *Special rule.* Paragraph (a) of this section shall be applied by substituting "Forty-five percent" for "Fifty percent" if clear and convincing evidence shows that, on the day of issue, both the issuer and holder reasonably believed that—

(1) The fair market value of the straight debt payments (as defined in paragraph (d)(2) of this section) with respect to the instrument is not less than

(2) Fifty percent of the fair market value of the instrument.

(c) *Meaning of terms.* The following rules apply for purposes of the regulations under section 385:

(1) *Contingent payment.* The term "contingent payment" means any payment other than a fixed payment of principal or interest.

(2) *Fixed payments; interest.* An instrument provides for fixed payments of interest if both of the following conditions are satisfied:

(i) Interest at a definitely ascertainable rate is due on definitely ascertainable dates.

(ii) Except as provided in paragraph (c)(5) of this section, the holder's right to receive interest when due (or within 90 days thereafter) cannot be impaired without the holder's consent.

(3) *Fixed payments; principal.* An instrument provides for the fixed payment of principal if both of the following conditions are satisfied:

(i) A definitely ascertainable principal sum is payable on demand or due on definitely ascertainable dates.

(ii) Except as provided in paragraph (c)(5) of this section, the holder's right to receive principal when due cannot be impaired without the holder's consent.

(4) *Definitely ascertainable.* (i) A rate of interest is definitely ascertainable if it is applied to a definitely ascertainable principal sum and it is—

(A) An invariable rate or

(B) A variable rate determined according to an external standard that is not subject to the borrower's control and that is not related to the success or failure of the borrower's business or activities.

(ii) A principal sum is definitely ascertainable if it is—

(A) An invariable sum or

(B) A variable sum determined according to an external standard that is not subject to the borrower's control and that is not related to the success or failure of the borrower's business or activities.

A principal sum is not variable simply because it is within the borrower's control to prepay all or a portion of the principal sum.

(5) *Exceptions.* The classification of a payment as fixed is not affected by the fact that:

(i) The instrument is issued under an indenture that satisfies the requirements of section 316 of the Trust Indenture Act of 1939 (15 U.S.C. §77ppp);

(ii) A holder's right to receive interest or principal may be impaired by the operation of the Federal bankruptcy laws (Title 11, U.S.C.), the Railroad Modification Act (47 U.S.C. §20b), or a similar provision of law;

(iii) A holder's right to receive interest or principal may be impaired in the event of the insolvency of the issuing corporation (either in the sense that the corporation is not able to pay its debts as they become due or in the sense that its liabilities exceed its assets);

(iv) the obligation to make the payment is a nonrecourse obligation, but only if the face amount of the obligation would, if the obligation were issued in exchange for property, be includible upon issuance of the purchaser's adjusted basis for the property; or

(v) with respect to an instrument issued in a redemption of stock, amounts designated as interest or principal (or both) are, by operation of local law, payable only out of earned surplus.

(6) *Illusory contingencies.* For purposes of this paragraph (d), the Commissioner may disregard a contingency where there is no reasonably foreseeable circumstance in which it would affect the likelihood of payment.

(7) *Certain guarantees.* If—

(i) A payment does not satisfy the requirements of paragraph (c)(2) or (3) of this section, but

(ii) The payment is guaranteed (directly or indirectly) by any person, then (depending on the facts and circumstances) the Commissioner may treat the payment as fixed.

(8) *Examples.* For examples that illustrate the application of this paragraph (c), see paragraph (a) of each of the examples in paragraph (f) of this section.

(9) *Other terms.* (i) For the definition of the term "fair market value", see §1.385-3(a).

(ii) For the definition of the term "hybrid instrument", see §1.385-3(d).

(iii) For the definition of the term "instrument", see §1.385-3(b).

(d) *Operating rules.*—(1) *In general.* Paragraph (a) of this section requires a comparison of the fair market value of the straight debt payments with respect to a hybrid instrument with the instrument's fair market value at the time it is issued. The rules in this paragraph (d) apply in determining the fair market value of the straight debt payments.

(2) *Straight debt payments.* The straight debt payments with respect to a hybrid instrument are determined as follows:

(i) the straight debt payments with respect to the right to fixed payments of principal or interest are the fixed payments themselves;

(ii) the straight debt payments with respect to the right to contingent payments (other than a call premium) are the payments that must be made on the occurrence of the contingencies resulting in the lowest possible fair market value of payments under the instruments. To the extent the payments are contingent in amount, the straight debt payments are computed assuming the occurrence of the contingency providing the smallest possible payment under the instrument. To the extent the payments are contingent as to timing, the straight debt payments are computed assuming the occurrence of the contingency providing payment on the latest possible date under the instrument. To the extent the payments are contingent on the exercise of discretion by the issuer of the instrument, the straight debt payments are computed assuming the smallest and latest possible discretionary payments. If the instrument is convertible into stock, the straight debt payments are computed without regard to the converti
bility feature.

(3) *Valuation.* The fair marke
value of the straight debt payment
with respect to a hybrid instrument i
the sum of the present value (at th
time of the instrument's issuance) c
each of the straight debt payments.

(4) *Discount rate.* (i) The discour
rate to be used in computing the pre
ent value of a straight debt paymen
payable at a future date is a reasona
ble rate of interest (within the mear
ing of §1.385-6(f)(1)) for an instru
ment in the amount of the straigh
debt payment, payable on the dat
that the straight debt payment mu
be made and payable on the terms an
conditions of such straight debt pay
ment.

(ii) Paragraph (d)(4)(i) of this se
tion may be illustrated by the follov
ing example:

Example. (a) Corporation X issues a class
10-year, 10-percent $1,000 subordinated i
come bonds to the public. Interest on the bon
is payable only if earned. The bonds have a fa
market value of $1,000 each. At approximate
the same time as the issuance of the incon
bonds, X issues to the public a class of 8-perce
subordinated bonds which are substantial
identical to the income bonds except that (
they bear interest at 8 percent and (2) the inte
est is payable at all events. Both classes of bon
are issued at their face amount and are reg
tered with the Securities and Exchange Comm
sion.

(b) The income bonds will be treated as i
debtedness if the fair market value of t
straight debt payments with respect to the bon
is at least 50 percent (or, in some cases, 45 pe
cent) of the fair market value of the bonds. S
paragraphs (a) and (b) of this section. In ord
for this test to be applied, the present value
the straight debt payments with respect to
bond (*i.e.*, a $1,000 subordinated payment
principal payable 10 years after issuance) mu
be determined. Based on the facts set forth
paragraph (a) of this example, it is appropria
to use an 8 percent discount rate in determini
the present value of the straight debt payment
$1,000, payable on a subordinated basis 10 yea
from the date of the issuance of the bonds.

(e) *Cross reference.* See §1.38
(b)(4) under which certain hybrid i
struments issued in exchange for pro
erty (other than money) are exclude
from the scope of the regulations u
der section 385.

(f) *Illustrations.* The following e
amples illustrate the application
this section. It is assumed that §1.38
6 does not apply to the instruments d
scribed in these examples.

Example (1). (a) On July 1, 1987, corpo
tion J issues subordinated income debent
bonds in the principal amount of $1,000 ea
The bonds pay interest at the rate of 8 percen
year. However interest is payable only if earn

The bonds are due on December 31, 2006. Based on these facts, each bond provides for a fixed payment of $1,000 in principal on December 31, 2006, but for contingent payments of interest.

(b) Assume that the fair market value of the 8-percent subordinated income debenture bonds is $1,000 each. The straight debt payments with respect to a subordinated income debenture bond are a $1,000 subordinated payment of principal due on December 31, 2006. Assume that the present value of such a payment on July 1, 1987 would be $261. Based on these facts, the subordinated income debenture bonds are treated as stock because the fair market value of the straight debt payments with respect to a debenture bond (*i.e.*, $261) is less than 50 percent of the bond's fair market value (*i.e.*, $1,000/2 = $500).

Example (2). (a) On March 1, 1988, corporation M issues 6-percent subordinated income debentures in the principal amount of $1,000 each due on March 1, 2038. Annual payment of interest is mandatory if net income is available and optional otherwise. Accumulated interest must be paid in all events at maturity. Based on these facts, each debenture provides for fixed payments of $1,000 in principal and $3,000 in simple interest on March 1, 2038.

(b) Assume that the fair market value of the 6-percent subordinated income debentures is $1,000 each. The straight debt payments with respect to a debenture are payments of $4,000 (total principal and interest) on March 1, 2038, with the payments being subordinated to the general creditors of M. Assume that the present value on March 1, 1988 of such payments with respect to a debenture would be $265. Based on these facts, the income debentures are treated as stock because the fair market value of the straight debt payments with respect to an income debenture (*i.e.*, $265) is less than 50 percent of the income debenture's fair market value (*i.e.*, $1,000/2 = $500).

Example (3). (a) On February 7, 1987, corporation P issues written obligations called "debenture preference stock" in the principal amount of $50 each. The debenture preference stock bears interest at 6 percent a year. In addition, at the discretion of the board of directors of P, the holders of the debenture preference stock may share in the profits of P after a dividend of $6 has been paid on each share of P's common stock. The debenture preference stock matures on December 31, 2017, except that the maturity may be extended from time to time (but in no event beyond December 31, 2037) at the discretion of P's board of directors. Based on these facts, the debenture preference stock provides for fixed payments of interest at a rate of 6 percent and a fixed payment of $50 in principal on December 31, 2037.

(b) Assume that the fair market value of the debenture preference stock is $50 each. The straight debt payments with respect to a share of debenture preference stock are annual payments of 6 percent interest and a $50 payment of principal due on December 31, 2037. Assume that the present value on February 7, 1987 of such payments would be $20.12. Based on these facts, the debenture preference stock is treated as stock because the fair market value of the straight debt payments with respect to a share of the debenture preference stock (*i.e.*, $20.12) is less than 50 percent of the share's fair market value (*i.e.*, $50/2 = $25).

Example (4). (a) On December 1, 1989, corporation T issues variable interest notes in the principal amount of $1,000 each. The notes pay interest at a rate that may vary between 2 percent and 10 percent, depending on the earnings of T. The board of directors of T may, in its discretion, defer all payments of interest until the notes mature on December 1, 2014, and may subordinate the notes to other debts of T. Based on these facts, each note provides for fixed payments of $1,000 in principal and $500 in interest (*i.e.*, 2 percent × $1,000 × 25 years) on December 1, 2014.

(b) Assume that the fair market value of the variable interest notes is $1,000 each. The straight debt payments with respect to a note are payments of $1,500 (total principal and interest) on December 1, 2014, with such payments being subject to subordination at the discretion of the board of directors of T. Assume that the present value on December 1, 1989 of such payments would be $219. Based on these facts, the variable interest notes are treated as stock because the fair market value of the straight debt payments with respect to a note (*i.e.*, $219) is less than 50 percent of the note's fair market value (*i.e.*, $1,000/2 = $500).

Example (5). (a) On April 1, 1984, corporation U issues inflation provision notes in the principal amount of $557,700. The notes pay interest at a fixed rate of 6 percent on a fluctuating maturity value, and are due on April 1, 1994. The maturity value is determined according to the Consumers' Price Index, published monthly by the Bureau of Labor Statistics. Based on these facts, the inflation provision notes provide for fixed payments of both principal and interest. See paragraph (c)(4)(i)(A) and (ii)(B) of this section.

(b) The inflation provision notes are treated as indebtedness because they are straight debt instruments.

Example (6). (a) Corporation W owns a tract of land and is building 350 houses there. On August 15, 1985, P lends $300,000 to W pursuant to a written agreement. The agreement provides that W will pay $175,000 to P "in lieu of interest," with $500 payable on the sale of each house. In addition, W is obligated to return P's $300,000 investment on demand at any time after December 31, 1990. The loan is secured by the general credit of W, and the written agreement contains appropriate protective provisions. Assume that the agreement is an instrument within the meaning of §1.385-3(b). Based on these facts, the agreement provides for the fixed payment of $300,000 in principal and for a contingent payment of $175,000.

(b) Assume that the fair market value of the obligation to P is $300,000. The straight debt payments with respect to the obligation are a $300,000 payment of principal due on December 31, 1990. Assume that the present value on August 15, 1985 of such a payment would be $170,000. Based on these facts, the obligation to P is treated as indebtedness because the fair market value of the straight debt payments with respect to the obligations (*i.e.*, $170,000) is not less than 50 percent of the obligation's fair market value (*i.e.*, $300,000/2 = $150,000).

Example (7). (a) On May 1, 1984, corporation X issues subordinated debentures due on May 1, 1994, in the principal amount of $1,000 each. Interest is payable annually at the fixed rate of 7 percent a year. Additional interest, which is contingent on the net profits of X, is payable at a maximum rate of 1 percent a year. Default in payment of interest, while not accelerating the maturity of the debenture, gives rise to a cause of action which the debenture holder may maintain against X for nonpayment or interest. Based on these facts, each debenture provides for a fixed $1,000 payment of principal and for fixed payments of interest at the rate of 7 percent a year.

(b) Assume that the fair market value of the subordinated debentures is $1,000 each. The straight debt payments with respect to a debenture are the same payments as the debenture provides without the provision for additional interest. Assume that the present value on May 1, 1984 of such payments would be $949. Based on these facts, the subordinated debentures issued by X are treated as indebtedness because the fair market value of the straight debt payments with respect to a debenture (*i.e.*, $949) is not less than 50 percent of the debenture's fair market value (*i.e.*, $1,000/2 = $500).

Example (8). (a) Corporation Z owns a large tract of land and is engaged in the business of developing, subdividing, and selling the land. On January 25, 1986, Z issues noninterest-bearing debenture bonds having a face value of $500,000 and a maturity date of January 25, 2011. The retirement of the bonds will be secured by the deposit of 10 percent of Z's gross receipts into a special bank account. However, if Z is liquidated after all of its lands have been sold, it will have no further obligation to retire any of the outstanding bonds unless the 10 percent payments have not been made as required. Based on these facts, the bonds do not provide for fixed payments of either principal or interest.

(b) The straight debt payments with respect to the debenture bonds are zero payments. Therefore, the debenture bonds are treated as stock.

Example (9). (a) On August 1, 1983, U, a domestic industrial corporation, issues debentures in the principal amount of 1,000 German marks each. The debentures pay interest at a fixed rate of 8 percent, are due on August 1, 1993, and provide for the payment of principal and interest in German marks. U immediately converts the proceeds from the issuance of the debentures into U.S. dollars and uses the money for its domestic business needs. Based on these facts, the debentures provide for fixed payments of both principal and interest. See paragraph (c)(4)(i)(B) and (ii)(B) of this section.

(b) The debentures are treated as indebtedness because they are straight debt instruments.

Example (10). (a) On September 1, 1984, corporation W issues floating rate notes in the principal amount of $100,000. The notes pay interest at 3 percentage points above the prime rate. Based on these facts, the floating rate notes provide for fixed payments of both principal and interest. See paragraph (c)(4)(i)(B) and (ii)(A) of this section.

(b) The floating rate notes are treated as indebtedness because they are straight debt instruments.

Example (11). (a) Unrelated individuals A and B each own 50 percent of the only class of stock of corporation X. In addition to the outstanding stock, X has outstanding debentures held by independent creditors. On January 1, 1988, X redeems all of A's stock in exchange for a 10-year note with a principal amount of $500,000. Under the terms of the note, interest on outstanding principal is payable annually at a rate of 10 percent. Under applicable local law, the note is treated as indebtedness. However, under local law, each payment of principal and interest is subject to the restriction that no payment may be made at a time when the corporation is (or would be rendered) insolvent (*i.e.*, unable to pay its debts as they become due). The insolvency restriction does not affect the classification of the principal or interest payments as fixed payments. See paragraph (d)(5)(iii) of this section. Therefore, the note provides for fixed payments of both principal and interest.

(b) The note is treated as indebtedness because it is a straight debt instrument. The result would be the same if, under local law, payments could not be made when X's liabilities exceeded its assets.

Example (12). (a) The facts are the same as in example (11) except that, under local law, the payments of principal and interest on the note are subject to the additional restriction that each payment can only be made out of X's earned surplus. Based on these facts, the earned surplus limitation does not affect the classification of the principal or interest payments as fixed payments. See paragraph (c)(5)(v) of this section. Therefore, the note provides for fixed payments of both principal and interest.

(b) The note is treated as indebtedness because it is a straight debt instrument.

Example (13). (a) On January 1, 1990, Corporation R purchases an office building from unrelated corporation S for a purchase price of $20 million. R pays $5 million in cash and issues a 15 year, 12-percent note for the remaining $15 million of the purchase price. The note is secured by a first mortgage on the office building but is otherwise nonrecourse with respect to R. Assume that under applicable principles of tax law (determined without reference to the regulations under section 385), R's adjusted basis for the building immediately after the purchase is $20 million (*i.e.*, the face amount of the note is includible in R's basis for the building). Based on these facts, the note provides for fixed payments of principal and interest.

(b) The note is treated as indebtedness because it is a straight debt instrument.

(g) *Additional illustrations.* The following examples are additional illustrations of the application of this section. It is assumed that §1.385-6 does not apply to the instruments described in these examples.

Example (1). On January 1, 1990, corporation M issues 7-percent Series A bonds in the principal amount of $1,000 each. The bonds are due on January 1, 2015, and are secured by the general credit of M. They are registered with the Securities and Exchange Commission and sold to the public at par. Because the Series A bonds are straight debt instruments, they are treated as indebtedness.

Example (2). The facts are the same as in example (1), except that the instruments issued by M are 9-percent Series B income bonds. Interest is not payable on the Series B income bonds unless earned and is noncumulative. The straight debt payments with respect to a Series B income bond are a $1,000 payment of principal due on January 1, 2015. Assume that the present value on January 1, 1990 of such a payment would be $184. Based on these facts, the Series B income bonds are treated as stock because the fair market value of the straight debt payments with respect to a Series B income bond (*i.e.*, $184) is less than 50 percent of the bond's fair market value (*i.e.*, $1,000/2 = $500).

Example (3). The facts are the same as in example (2), except that the Series B income bonds are due on January 1, 2000. The straight debt payments with respect to a Series B income bond are a $1,000 payment of principal due on January 1, 2000. Assume that the present value, on January 1, 1990 of such a payment would be $508. Based on these facts, the Series B income bonds are treated as indebtedness because the fair market value of the straight debt payments with respect to a Series B income bond (*i.e.*, $508) is not less than 50 percent of the bond's fair market value (*i.e.*, $1,000/2 = $500).

Example (4). The facts are the same as in example (3), except that the Series B income bonds bear 10-percent interest and are subordinated to the general creditors of M. The straight debt payments with respect to a Series B income bond are a $1,000 payment of principal due on January 1, 2000, with such payment being subordinated to the general creditors of M. Assume that the present value on January 1, 1990 of such a payment would be $463. Based on these facts, the Series B income bonds are treated as stock because the fair market value of the straight debt payments with respect to a Series B income bond (*i.e.*, $463) is less than 50 percent of the bond's fair market value (*i.e.*, $1,000/2 = $500).

Example (5). The facts are the same as in example (2), except that the Series B income bonds pay 8-percent cumulative interest, and accumulated interest becomes unconditionally due at maturity. The straight debt payments with respect to a Series B income bond are payments of $3,000 (total principal and interest) due on January 1, 2015. Assume that the present value on January 1, 1990 of such payments would be $553. Based on these facts, the Series B income bonds are treated as indebtedness because the fair market value of the straight debt payments with respect to a Series B income bond (*i.e.*, $553) is not less than 50 percent of the bond's fair market value (*i.e.*, $1,000/2 = $500).

Example (6). The facts are the same as in example (1), except that the instruments issued by M are 6-percent Series C convertible bonds. Each Series C bond is convertible into two shares of common stock of M. The straight debt payments with respect to a Series C bond are the same payments as the bond provides without the conversion feature. Assume that the present value on January 1, 1990 of such payments (in effect, the value of the bond without the conversion feature) would be $883. Based on these facts, the Series C convertible bonds are treated as indebtedness because the fair market value of the straight debt payments with respect to a Series C bond (*i.e.*, $883) is not less than 50 percent of the bond's fair market value (*i.e.*, $1,000/2 = $500).

Example (7). The facts are the same as in example (6), except that the Series C convertible bonds pay 2-percent interest and are convertible into four shares of stock of M. The straight debt payments with respect to a Series C bond are the same payments as the bond provides without the conversion feature. Assume that the present value on January 1, 1990 of such payments (in effect, the value of the bond without the conversion feature) would be $417. Based on these facts, the Series C convertible bonds are treated as stock because the fair market value of the straight debt payments with respect to a Series C bond (*i.e.*, $417) is less than 50 percent of the bond's fair market value (*i.e.*, $1,000/2 = $500).

Example (8). The facts are the same as in example (1), except that the instruments issued by M are 7-percent Series D convertible income bonds due on January 1, 2015. The Series D bonds are convertible into two shares of common stock of M, and accumulated interest on the Series D bonds is unconditionally due at maturity. The straight debt payments with respect to a Series D bond are payments of $2,750 (total principal and interest) due on January 1, 2015 (and also disregarding the conversion feature). Assume that the present value on January 1, 1990 of such payments would be $506. Based on these facts, the Series D convertible income bonds are treated as indebtedness because the fair market value of the straight debt payments with respect to a Series D bond (*i.e.*, $506) is not less than 50 percent of the bond's fair market value (*i.e.*, $1,000/2 = $500).

Example (9). The facts are the same as in example (4), except that the Series B income bonds are privately placed with corporation X. In reliance on an independent appraisal, both X
and M reasonably believe that the fair m
value of the straight debt payments with re
to a Series B income bond is $510. Base
these facts, the Series B income bonds are t
ed as indebtedness. See paragraph (b) of
section.

§1.385-6 Proportionality.

(a) *In general*—(1) *Scope.*
section applies to a class of instrum
if holdings of stock and the class o
struments are substantially pro
tionate. This section affects ins
ments issued for inadequate or ex
sive consideration, hybrid ins
ments, instruments not issued
money, instruments that are pay
on demand, and certain other ins
ments where there is a change in te
or a failure to pay principal or in
est, or where a corporation's deb
equity ratio is excessive.

(2) *Proportionality*—(i) *In gene*
Holdings of stock and a class of ins
ments are substantially proportio
if the "total overlap factor" with
spect to the class of instrument
greater than 50 percent. The "
overlap factor" is the sum of the o
lap factors of each person with res
to the class of instruments. The o
lap factor of a person with respect
class of instruments is the lesser of
percentage of stock or the percen
of the class of instruments owned,
tually or constructively, by the pers

(ii) *Constructive ownership*
For purposes of computing the ove
factors under paragraph (a)(2)(i
this sectioin, the constructive ow
ship rules of section 318(a) shall be
plied to attribute the ownershi
stock and instruments in accord
with the following special rules:

(A) For purposes of section
(a)(1)(ii), an individual shall als
considered to own stock or instrum
owned, directly or indirectly, by o
his or her brothers and sisters (wh
by the whole or half blood).

(B) Stock or an instrument
structively owned under section
(a)(4) (relating to options) sha
taken into account only to the e
that (whether or not the option
currently exercisable) it is reaso
to expect, as of the time the rel
determination is made, that th
tions may be exercised.

(C) Section 318(a)(2)(C) sha
applied without regard to the 5
cent minimum percentage own

requirement.

(D) If, in applying the attribution rules of section 318(a) (as modified by this subdivision (ii)) to both stock and a class of instruments, stock owned by one or more shareholders of a corporation or instruments owned by one or more holders would be attributed to one or more other persons, then the total overlap factor shall be determined by taking the largest total overlap factor that can be produced (without double counting) by computing holdings of stock and instruments under this subdivision (ii).

(E) A person's overlap factor shall be taken into account whether or not the person actually owns any stock or instruments of a corporation.

(iii) *Definition of "stock."* For purposes of paragraphs (a)(2)(i) and (ii) of this section, the term "stock" is defined as follows:

(A) If the issuing corporation has only one class of stock, then "stock" means all outstanding shares of this class of stock.

(B) If the issuing corporation has more than one class of stock, then the classes of stock which constitute "stock" will be determined based on the facts and circumstances. In general, a class of stock will be considered "stock" if it participates in corporate growth or has other characteristics which would reduce the incentive of holders of such class to establish or enforce arm's length terms on instruments issued to such holders. See examples (7) and (12) of paragraph (a)(6) of this section.

(iv) *Special rule for redemptions.* (A) If—

(1) A corporation issues a straight debt instrument to a shareholder in redemption of all or part of the shareholder's stock in the corporation,

(2) Section 302(a) would apply to the redemption if the instrument were treated as indebtedness,

(3) The stated interest rate on the instrument is not less than the rate prescribed by the Secretary pursuant to section 483(c); and

(4) This section would, but for this paragraph (a)(2)(iv), apply to the instrument,

then the instrument is initially classified as indebtedness upon issuance and paragraph (c) of this section does not apply to the instrument. However, the instrument may subsequently be reclassified as stock under paragraphs (k), (l), and (m) of this section.

(B) For purposes of paragraph (a)(2)(iv)(A) of this section, an instrument will be treated as a straight debt instrument notwithstanding that amounts designated as interest or principal (or both) are, by operation of local law, payable only out of earned surplus.

(v) *Special rule for cooperatives.* In determining proportionality for holdings in a cooperative, interests described in §1.385-1(b)(2) will be treated as stock.

(vi) *Special rule for major shareholders.* Notwithstanding paragraph (a)(2)(i) of this section, holdings of an instrument and the issuing corporation's stock will be treated as substantially proportionate if—

(A) the instrument is held by a person who owns (actually or constructively by application of section 318(a) as modified by paragraphs (a)(2)(ii)(A), (B), and (C) of this section) stock possessing at least 25 percent of the total combined voting power of all classes of stock entitled to vote or at least 25 percent of the total value of shares of all classes of the corporation's stock; and

(B) the corporation's debt-to-equity ratio, computed in accordance with paragraphs (h) and (j) of this section, exceeds 10:1 at the end of the taxable year in which the instrument is issued.

(vii) *Examples.* The following examples illustrate the application of this paragraph (a)(2):

Example (1). The only class of stock of corporation X and a class of its instruments are owned as follows by unrelated individuals A, B, C, and I:

	A	*B*	*C*	*I*
Stock	40%	10%	50%	0%
Instruments	20%	60%	10%	10%

The "total overlap factor" with respect to the class of instruments is 20% + 10% + 10%, or 40%, and, accordingly, holdings of the X stock and the class of instruments are not substantially proportionate.

Example (2). Individuals B, BW (B's wife), BC (B's child), S (B's sister) and SH (S's husband) own the only class of stock of corporation Y and a class of its debentures as follows:

	B	*BW*	*BC*	*S*	*SH*
Stock	0%	100%	0%	0%	0%
Debentures	0%	0%	50%	25%	25%

The largest overlap factor that can be produced by computing holdings of stock and instruments under the section 318(a) attribution rules, as modified by paragraph (a)(2)(ii) of this section, is 75 percent, produced as follows:

	B (including holdings of BW, BC, and S)	*SH*
Stock	100%	0%
Debentures	75%	25%

Therefore, holdings of the Y stock and the class of debentures are substantially proportionate. If, however, B were decreased, the total overlap factor would be 50 percent and, accordingly, holdings of the Y stock and the class of debentures would not be substantially proportionate.

Example (3). Twenty-five unrelated individuals each own 4 percent of the only class of stock of corporation P which, in turn, owns 100 percent of the only class of stock of corporation S. The same individuals each own 4 percent of a class of debentures issued by S. Under section 318(a)(2)(C), as modified by paragraph (a)(2)(ii)(C) of this section, each individual shareholder of P is considered to own 4 percent of the stock of S. Thus, the overlap factor of each P shareholder with respect to the debentures issued by S is 4 percent. Therefore, the total overlap factor with respect to the debentures is 100 percent and holdings of the S stock and the debentures are substantially proportionate.

Example (4). The only class of stock of corporation Z and a class of its instruments are owned as follows:

	Corporation W	*Corporation X*	*Corporation Y*
Stock	30%	10%	60%
Instruments	40%	60%	0%

Individual A owns all of the stock of corporations W and X.

Individual B owns all of the stock of corporation Y. A owns 100 percent of a class of straight debt instruments issued by Y. A, B, W, X and Y are otherwise unrelated.

The largest overlap factor that can be produced by computing holdings under the section 318 attribution rules (as applied to both stock and instruments) is 40 percent, computed as follows:

	A (including holdings of W and X)	*Y*
Stock	40%	60%
Instruments	100%	0%

Therefore, holdings of the Z stock and the class of instruments are not substantially proportionate.

(3) *Exceptions.* (i) This section does not apply if a corporation's stock and instruments are widely held and the instruments are separately traded and readily marketable.

(ii) This section does not apply to any instrument held by an independent creditor (as defined in paragraph (b) of this section).

(4) *Two classes treated as one.* Depending on the facts and circumstances, two or more classes of instruments may be considered together. For example:

(i) If—

(A) Two or more classes of instruments are issued pursuant to a plan, and

(B) Holdings of stock and the instruments will be substantially proportionate on completion of the plan,

then this section applies to each instrument immediately after it is issued.

(ii) If (regardless of whether issued pursuant to a plan)—

(A) Subsequent to their issuance, two or more classes of instruments are treated as a single class, and

(B) Considered as a single class, holdings of stock and such class are substantially proportionate,

then this section applies to each class beginning at the time of such treatment.

(5) *One class treated as two.* If two portions of a class of instruments are treated differently (*e.g.*, interest is paid on one portion but not on the other), then each portion is treated as a separate class beginning at the time of such treatment.

(6) *Illustrations.* The following examples illustrate the application of this paragraph (a). Except as otherwise provided, all persons in these examples are unrelated.

Example (1). A, B, and C each own 100 shares of common stock in corporation Y. Y has no other stock of any class outstanding. However, Y does have outstanding subordinated 8-percent debentures in the principal amount of $100,000. A owns $40,000 of the debentures, B owns $30,000, C owns $20,000, and an independent creditor owns the remaining $10,000. Based on these facts, the total overlap factor with respect to the debentures is 83⅓ percent and holdings of the debentures and holdings of stock in Y are thus substantially proportionate. Therefore, this section applies to the debentures held by A, B and C. However, this section does not apply to the debentures held by the independent creditor.

Example (2). A, B, and C each own ⅓ of the common stock of corporation Z. Pursuant to a plan, Z issues $100,000 of 10-year, 8-percent debentures to A, $100,000 of 12-year, 8-½-percent debentures to B, and $100,000 of 15-year, 9-percent debentures to C. Based on these facts, upon completion of the plan, the total overlap factor with respect to the debentures is 100 percent and holdings of the debentures and Z's stock are thus substantially proportionate. See paragraph (a)(4)(i) of this section. Therefore, this section applies to the debentures.

Example (3). Corporation P owns all the stock of corporations S and T. In addition, S owns 80 percent of a class of debentures issued by T. The other 20 percent of the debentures is owned by an independent creditor. Based on these facts, the total overlap factor with respect to the debentures is 80 percent and holdings of the T stock and debentures are thus substantially proportionate. Therefore, this section applies to the debentures held by S but not those held by the independent creditor.

Example (4). Corporation V has more than 100,000 shareholders. On January 1, 1990, V issues $10 of debentures on each share of stock as a dividend. The stock and debentures are traded separately on a national securities exchange. Based on these facts, this section does not apply to the debentures.

Example (5). A owns all 100 shares of stock in corporation Y. A also owns 50 percent of a class of senior debentures issued by Y, and B owns the remaining 50 percent. In addition, B owns all of a class of junior debentures issued by Y, which are convertible into a total of 100 shares of Y stock. Further, it is reasonable to expect that B may ultimately exercise the conversion privilege. Based on these facts, the total overlap factor with respect to the senior debentures is 100 percent and holdings of stock in Y and the senior debentures are thus treated as substantially proportionate under paragraph (a)(2) of this section. Consequently, this section applies to the senior debentures. However, the total overlap factor with respect to the junior debenture is 50 percent and, therefore, holdings of Y stock and the junior debentures are not substantially proportionate.

Example (6). A owns all 100 shares of stock of corporation U. In addition, B owns $100,000 of convertible debentures issued by U. The debentures are convertible into 1,000 shares of U's common stock. Assume that it is reasonable to expect that B may ultimately exercise the conversion privilege. Based on these facts, B is treated as owning 1,000 shares of U common stock. Thus, the total overlap factor with respect to the convertible debentures is 90.9 percent and holdings of the convertible debentures and stock in U are thus substantially proportionate. Therefore, this section applies, and the convertible debentures are treated as stock under paragraph (d) of this section (relating to hybrid instruments).

Example (7). Corporation M is a large manufacturing company whose products are sold through independent dealers. In order to assist individuals who do not have enough capital to become dealers, M has established a dealer investment plan. Pursuant to the dealer investment plan, M and unrelated individual I organize corporation D on January 1, 1982. M transfers $900,000 to D in exchange for 10-percent notes in the principal amount of $500,000 and 400 shares of class A stock. I transfers $100,000 to D in exchange for 1,000 shares of class B stock. The class B stock is nonvoting until all the class A shares are redeemed for $1,000 each. At least 70 percent of D's earnings and profits must be used each year to retire the notes and to redeem the class A stock. I has no control over the redemption of stock and no right to have his stock redeemed while any of the class A stock is outstanding. M's investment will thus be systematically eliminated, and I will become the sole owner of D. Because the plan is akin to a security arrangement and is not intended to give M a meaningful interest in the corporate growth of D, the class A stock is not considered "stock" within the meaning of paragraph (a)(2)(iii) of this section. Therefore, holdings of the stock and notes are not substantially proportionate. *Cf.* example (14) of §1.305-3(e). Therefore, this section does not apply to the notes. However, for purposes of section 1232 (relating to original issue discount), the issue price of the notes is equal to their fair market value. See §1.1232-3(b)(2)(ii) (relating to investment units).

Example (8). Corporation S is a small business investment company operating under the Small Business Investment Act of 1958 (15 U.S.C. 661 and following). Individual J is an electrical engineer. On January 1, 1983, S and J, who are otherwise unrelated, form corporation X to manufacture high technology electrical components. X has a total authorized capital of 2,000 shares of common stock. S transfers $810,000 to X for 9-percent subordinated debentures in the principal amount of $800,000, 100 shares of common stock, and warrants to acquire an additional 900 shares of common stock at $100 a share. Assume it is reasonable to expect that the warrants may be exercised. J transfers $100,000 to X for 1,000 shares of common stock. Based on these facts, the total overlap factor with respect to the subordinated debentures is 50 percent and holdings of the stock and debentures thus are not substantially proportionate. Therefore, this section does not apply to the subordinated debentures. However, for purposes of section 1232 (relating to original issue discount), the issue price of the debentures is equal to their fair market value. See §1.232-3(4)(2)(ii) (relating to investment units).

Example (9). Corporation T is a medium-sized supplier of computer software. Individual K is the manager of T's military applications division. On January 1, 1984, K forms corporation Y to acquire the assets of T's military applications division. K transfers $100,000 to Y for all 100 shares of Y's outstanding common stock. In addition, Y obtains financing from the following sources: $2 million from a small business investment company for 8-percent junior subordinated debentures and warants to acquire 100 shares of common stock, $3 million from an insurance company for 14-percent senior subordinated debentures, and $2,500,000 from a bank for 10-percent secured notes. K is not otherwise related to T, the small business investment company, the insurance company, or the bank. Based on these facts, there is no substantial proportionality between holdings of stock and any class or classes of instruments. Therefore, this section does not apply to any of the instruments. However, for purposes of section 1232 (relating to original issue discount), the issue price of the junior subordinated debentures is equal to their fair market value. See §1.1232-3(b)(2)(ii) (relating to investment units).

Example (10). A is the sole shareholder of corporation X. On January 1, 1987, X issues $50,000 of class B debentures to A and $50,000 of class B debentures to independent creditor K. Based on these facts, the total overlap factor with respect to the class B debentures is 50 percent and holdings of the X stock and the class B debentures are thus not substantially proportionate. However, on January 1, 1989, A voluntarily subordinates his debentures to K's. Based on these facts, under paragraph (a)(5) of this section, A's debentures are treated as a separate class beginning on January 1, 1989. Thus, this section applies to A's debentures and they may be treated as stock under paragraph (k) of this section (relating to a change in terms). The result would be the same if, on January 1, 1989, X missed an interest payment due on A's debentures, but made the payment on K's debentures. In this event, A's debentures might be treated as stock under paragraph (l) of this section (relating to nonpayment of interest).

Example (11). (a) A and B each own 50 percent of the stock of corporation Z, a calendar year taxpayer. Pursuant to a plan, Z issues $100,000 of class A convertible debentures to A on January 1, 1983 and issues $100,000 of class B convertible debentures to B on January 1, 1985. Based on these facts, the two classes of debentures are considered together. Therefore, holdings of the debentures and the stock are substantially proportionate and each class of debentures is treated as stock upon issuance under paragraph (d) of this section (relating to hybrid instruments issued proportionately).

(b) The facts are the same as in paragraph (a) of this example except that the two classes of debentures are not issued pursuant to a plan. Based on these facts, this section does not apply to either class of debentures upon their issuance.

(c) The facts are the same as in paragraph (b) of this example except that Z fails to pay interest on the debentures accrued during 1989. Based on these facts, the two classes of debentures are treated as one class as of January 1, 1989 and the debentures may be treated as stock under paragraph (l) of this section (relating to nonpayment of interest). See paragraph (a)(4)(ii) of this section.

Example (12). E owns all of the common stock of corporation X. In addition, F owns all of the preferred stock of X. The preferred stock is an 8 percent nonparticipating, nonconvertible, nonvoting preferred stock. Further, E owns a class of debentures issued by X. Based on these facts, this preferred stock is not treated as stock for purposes of determining proportionality and, accordingly, the total overlap factor with respect to the debentures is 100 percent. Therefore, holdings of the X stock and debentures are substantially proportionate and, thus, this section applies to the debentures. However, if F owned all of the debentures, the total overlap factor with respect to the debentures would be zero and this section would not apply.

(7) *Special rule*. (i) If, pursuant to an agreement or arrangement—

(A) The terms of an instrument issued to a shareholder are not fixed at arm's length or the instrument is not enforced according to its terms, and

(B) There are related, compensating non-arm's length transactions, then the Commissioner may treat holdings of the instrument and the corporation's stock as substantially proportionate.

(ii) The following examples illustrate the application of this subparagraph (7):

Example (1). A and B each own 50 percent of the common stock of corporation X. On January 1, 1985, A lends $500,000 to X in exchange for a 10-year 10-percent $500,000 note. B is the general manager of X. During 1987, pursuant to an arrangement between A and B, X does not pay the $50,000 of interest on A's note and X pays B $50,000 less compensation than he would be entitled to under B's employment contract with X. Based on these facts, holdings of X's stock and the note will be treated as substantially proportionate. Therefore, this section applies to the note and the note may be reclassified as stock under paragraph (l) of this section (relating to nonpayment of interest).

Example (2). C and D each own 50 percent of the stock of corporation Y. On January 1, 1987, C leases a townhouse to Y for a ten-year term. Y agrees to pay an annual rent of $10,000 and additional rent equal to 20 percent of the net annual rentals from the townhouse. Also on January 1, 1987, as part of the same arrangement, D lends $100,000 to Y in exchange for a 10-year debenture. Ten percent annual interest is payable on the debenture. In addition, the holder of the debenture is entitled to contingent annual interest equal to 20 percent of the net annual rentals from the townhouse. Based on these facts, holdings of the debenture and Y's stock shall be treated as substantially proportionate. Accordingly, the debenture will be treated as stock under paragraph (d) of this section (relating to hybrid instruments issued proportionately).

(b) *Independent creditor*—(1) *In general*. For purposes of the regulations under section 385, all relevant facts and circumstances must be taken into account in determining whether a creditor is independent. Relevant factors that may be taken into account include (but are not limited to) the following:

(i) Whether the creditor has stock holdings (direct or attributable) in the issuing corporation and, if so, the size of such holdings;

(ii) Whether the creditor has a relationship with the corporation other than that of a creditor, *e.g.*, as an employee, supplier, or customer; and

(iii) Whether the creditor is related to the individual shareholders of the issuing corporation or of a corporation related to the issuing corporation, including (but not limited to) the relationships described in section 318(a).

(2) *Safe harbor*. In applying this section to a class of instruments issued by a corporation, a creditor is deemed to be independent if—

(i) The creditor does not own, directly or by attribution under the constructive ownership rules of section 318(a), as modified by paragraph (b)(3) of this section, at least 5 percent of the total combined voting power of all classes of stock entitled to vote or at least 5 percent of the total value of shares of all classes of the corporation's stock;

(ii) The creditor does not own, directly or by attribution under the constructive ownership rules of section 318(a) as modified by paragraph (b)(3) of this section, at least 5 percent of the stock owned by the corporation; and

(iii) The creditor's (actual or constructive) percentage ownership of the class of instruments is at least twice as great as the greater of the creditor's (actual or constructive) percentage ownership of (A) the total combined voting power of all classes of stock entitled to vote or (B) the total value of shares of all classes of the corporation's stock.

(3) *Constructive ownership*. For purposes of subparagraph (2) of this paragraph (b), the attribution rules of section 318(a) shall be applied with the following modifications—

(i) For purposes of section 318(a)(1)(ii), an individual shall also be considered to own stock or instruments owned, directly or indirectly, by or for his or her brothers and sisters (whether by the whole or half blood);

(ii) Section 318(a)(2)(C) shall be applied without regard to the 50 percent minimum percentage ownership requirement;

(iii) Section 318(a)(3)(C) shall be applied by substituting "5 percent" for "50 percent"; and

(iv) In determining whether any person owns 5 percent or more of the stock of a corporation, stock constructively owned under section 318(a)(4) (relating to options) by a person whose interests in the corporation would not be attributed under section 318(a) to the person whose interests are being tested is not taken into account.

(4) *Illustrations*. The following examples illustrate the application of this paragraph (b):

Example (1). Individual C owns (actually or under the constructive ownership rules of section 318(a) as modified by paragraph (b)(3) of this section) 5 percent or more in value of the stock of corporation Y. Based on these facts, C does not satisfy the conditions of either paragraph (b)(2)(i) or paragraph (b)(2)(ii) of this section. Consequently, C does not come within the safe harbor of paragraph (b)(2) of this section with respect to instruments issued by Y.

Example (2). Individual A owns all 100 outstanding shares of stock and an option to acquire an additional 1,000 shares of stock in corporation X. Individual B owns an option to acquire 10 shares of stock in X. Applying the constructive ownership rules of section 318(a) as modified by paragraph (b)(3) of this section, B is considered to own 10 out of 110 outstanding shares of stock in X. Therefore, B does not come within the safe harbor of paragraph (b)(2) of this section. The result would be the same if the option owned by B were owned by B's spouse.

Example (3). Corporation Y obtains a $100,000 loan from C, an unrelated commercial bank. As a condition for making a loan, C obtains the right to designate one of Y's directors. Based on these facts, C is an independent creditor of Y.

Example (4). Individual E owns 97 percent of the only class of stock of corporation Z, and unrelated individual F owns the remaining 3 percent. In addition, E owns 96.2 percent of a class of debentures issued by Z, and F owns the remaining 3.8 percent. Because F's percentage ownership of the class of debentures is not at least twice as great as F's percentage ownership of the Z stock, F does not come within the safe harbor of paragraph (b)(2) of this section.

(c) *Excessive or inadequate consideration*—(1) *Excessive consideration*. If, immediately after an instrument is issued by a corporation, this section applies to the instrument and the instrument is treated as indebtedness, then the excess of—

(i) The consideration paid, over

(ii) The fair market value of the instrument,

is treated as not paid in exchange for the instrument. Ordinarily, such excess is treated as a contribution to capital. However, under appropriate circumstances, it may be treated as a gift followed by a capital contribution or as compensation for services or as otherwise determined under general principles of tax law.

(2) *Inadequate consideration*. If, immediately after an instrument is issued by a corporation, this section applies to the instrument and the instrument is treated as indebtedness, then the excess of—

(i) The fair market value of the instrument, over

(ii) The consideration paid,

is treated as not transferred in exchange for the consideration paid. Ordinarily, such excess is treated as a distribution to which section 301 applies. See §1.301-1(d), (j) and (k). However, under appropriate circumstances, it may be treated as a distribution to which section 301 applies followed by a gift or as compensation for services or as otherwise determined under general principles of tax law.

(3) *Consequences if instrument treated as stock*. If, immediately after an instrument is issued by a corporation, the instrument is treated as stock, then the treatment of amounts described in paragraphs (c)(1) and (2) of this section shall be determined outside the regulations under section 385.

(4) *Illustrations*. The following examples illustrate the application of this paragraph (c) and related provisions:

Example (1). Corporation S is organized in 1985 for the purpose of constructing, owning, and operating a professional office building. Fifteen persons, all medical doctors, subscribe for the capital stock of S at $100 a share. On January 1, 1988, the doctors agree to advance $300 to S for each share of stock subscribed. These advances are represented by 19-year, 7-percent debentures in the principal amount of $300 each. Assume that the debentures are treated as indebtedness under §1.385-4(a) (relating to instruments generally), and that the fair market value of each debenture is $246. Based on these facts, $54 of each $300 advance is treated as a contribution to capital. Therefore, the doctors' basis in each debenture is $246, and there is an original issue discount of $54 on each debenture. See section 1232.

Example (2). The facts are the same as in example (1), except that the doctors pay $200 for each debenture. Based on these facts, the doctors are treated as receiving a $46 distribution to which section 301 applies on each share of stock. Therefore, the doctors' basis in each debenture is $246 (see §1.301-1(j)), and there is an original issue discount of $54 on each debenture.

Example (3). The facts are the same as in example (1), except that the debentures bear interest at 9 percent a year. Assume that the fair market value of each 9-percent debenture is $300. Based on these facts, the doctors are not treated as making a contribution to capital or as receiving a distribution to which section 301 applies. Therefore, the doctors' basis in each debenture is $300, and there is no original issue discount on the debentures.

Example (4). The facts are the same as in example (1), except that S issues the debentures together with the capital stock in 1985, and the doctors pay $400 for each unit consisting of one debenture and one share of stock. Based on these facts, the doctors' basis in each debenture is $246 (see §1.1012-1(d)), their basis in each share of stock is $154, and the original issue discount on each debenture is $54 (see §1.1232-3(b)(2)(ii)).

Example (5). Individuals A and B each own ½ the common stock of corporation M, which is the only class of stock outstanding. On January 1, 1983, M issues two 12-percent $1,000 notes, one to A and one to B, each for $1,000 in cash. Assume that the fair market value of each note is $1,250 and that the notes are treated as indebtedness under §1.385-4(a) (relating to instruments generally). Based on these facts, on January 1, 1983, A and B each receive a $250 distribution to which section 301 applies. Thus, each note has a basis of $1,250 and is issued at a premium of $250 (see section 171(b), §1.171-3(d) and §1.61-12(c)(2)).

(d) *Hybrid instruments*—(1) *In general*. If this section applies to a hybrid instrument immediately after it is issued, then, except as provided in paragraph (d)(2) of this section, the instrument is treated as stock.

(2) *Exception*. If, immediately after a class of hybrid instruments is issued, independent creditors (determined without regard to paragraph (b)(2) of this section and without taking into account the creditor's holdings of the hybrid instrument at issue) own at least 20 percent of the class, then paragraph (d)(1) of this section does not apply to the class. However, even if the exception provided by this paragraph (d)(2)(ii) applies to a class of hybrid instruments, the instruments remain subject to §1.385-5 and (except for the instruments held by independent creditors) remain subject to paragraphs (k), (l), and (m) of this section.

(3) *Hybrid instrument*. For the definition of the term "hybrid instrument," see §1.385-3(d).

(4) *Illustration*. The following example illustrates the application of this paragraph (d):

Example. Corporation X's only outstanding stock is 100 shares of common stock. Individual A owns 40 shares, individual B owns 30 shares, and individual C owns 30 shares. On January 1, 1990, X issues $100,000 of convertible debentures. Sixty thousand dollars of the convertible debentures are issued to A, $25,000 are issued to B, and the remaining $15,000 are issued to C. Based on these facts, the convertible debentures are treated as stock.

(e) *Instruments not issued for money*—(1) *In general*. An instrument issued by a corporation is treated as stock if—

(i) This section applies to the instrument immediately after it is issued,

(ii) The stated annual rate of interest on the instrument is not reasonable (within the meaning of paragraph (f) of this section), and

(iii) The issuance of the instrument does not give rise to original issue discount under section 1232(a)(3) or amortizable bond premium under §1.61-12(c)(2).

(2) *Special rule*. For purposes of this paragraph (e), the reasonableness of a rate of interest is determined on the day an instrument is issued.

(3) *Exception*. (i) This paragraph (e) does not apply to an instrument that is issued in exchange for an equal or greater principal amount of indebtedness of the issuing corporation if—

(A) An independent creditor holding the outstanding indebtedness would, in the exercise of ordinary diligence, have agreed to the exchange, and

(B) The issuing corporation would, in the exercise of ordinary diligence, have agreed to make the exchange with an independent creditor holding the outstanding indebtedness.

(ii) For purposes of subdivision (i) of this subparagraph (3), the principal amount of indebtedness includes interest accrued but unpaid up until the date of the exchange, but only to the extent that such interest is paid with principal in the exchange.

(4) *Illustrations*. The following examples illustrate the application of this paragraph (e):

Example (1). J organizes corporation W on December 10, 1985 to operate a distributorship of radios, television sets, and other types of electrical appliances. On the same day, J transfers certain franchises, and other assets to W in exchange for all of W's capital stock and $100,000 of 10-year, 9-percent debenture bonds. Assume that on December 10, 1985, 9 percent is not a reasonable rate of interest (within the meaning of paragraph (f) of this section). Based on these facts, the debenture bonds are treated as stock.

Example (2). Corporation X operates a wholesale electrical supply business. In the course of a recapitalization on December 30, 1990, X issues 2,100 of new class B debentures (the entire class) to L in exchange for X common stock. Immediately after the recapitalization, L holds 90 percent of the common stock of X. The principal amount of each class B debenture is $100, and each debenture pays $50 a year in interest. Assume that on December 30, 1990, 50 percent is not a reasonable rate of interest (within the meaning of paragraph (f) of this section). Based on these facts, the class B debentures issued to L are treated as stock.

Example (3). On January 1, 1987, individuals A, B and C transfer a tract of undeveloped land and $4,500 in cash to newly formed corporation X. In exchange, each receives 100 shares of stock and a 2-year, 10-percent promissory note for $110,000. Assume that 10 percent is not a reasonable rate of interest (within the meaning of paragraph (f) of this section). Based on these facts, the promissory notes are treated as stock for all purposes of the Internal Revenue Code. In particular, the notes are not treated as "other property" within the meaning of section 351(b). Thus, no gain or loss is recognized on the transfer of the land to X (see section 351), and X's basis in the land is the same as it was in the hands of A, B, and C (see section 362(a)(1)).

Example (4). B is the sole shareholder of corporation Y. On January 1, 1990, Y issues a $30,000, 10 percent note to B in exchange for $30,000. The note is due on January 1, 2000 and is treated as indebtedness under §1.385-4(a). Interest on the note is paid according to its terms through 1999. During 1999, Y encounters business difficulties. On December 11, 1999, Y issues a new note to B in exchange for the outstanding note. The terms of the new note are identical to those of the outstanding note except that the new note is due on January 1, 2002 and is subordinated to a new bank loan being made at the time of the exchange. Assume that an independent creditor holding the outstanding note would, in the exercise of ordinary diligence, have agreed to exchange the outstanding note for the new note. Assume also that Y would, in the exercise of ordinary diligence, have agreed to the exchange even if the outstanding note were held by an independent creditor. Based on these facts, the exception of paragraph (e)(3) of this section applies and, therefore, this paragraph (e) does not apply to the new note. However, the new note is subject to paragraph (k), (l), and (m) of this section.

(f) *Reasonable rate of interest*—(1) *In general.* The annual rate of interest on an instrument issued by a corporation is reasonable if it is within the normal range of rates paid to independent creditors (determined without regard to paragraph (b)(2) of this section) on similar instruments by corporations of the same general size and in the same general industry, geographic location, and financial condition on the date the determination is made. In no event will the rate of interest on an instrument (other than an instrument to which paragraph (f)(2) of this section applies) be considered reasonable for purposes of this paragraph (f)(1) if it is less than the rate determined by the Secretary pursuant to paragraph (f)(2)(i)(A) of this section for instruments of comparable maturity.

(2) *Rule of convenience.* For purposes of the regulations under section 385, an annual rate of interest on an instrument is considered to be reasonable if—

(i) On the date the determination is made, (A) it is equal to the rate in effect under section 6621, the prime rate in effect at any local commercial bank (or a rate two points above such rate), either of the endpoints of the range of rates set forth in §1.482-2(a)(2)(iii)(B)(1), or a rate determined from time to time by the Secretary taking into consideration the average yield on outstanding marketable obligations of the United States of comparable maturity or (B) it is in between any two of the rates described in subdivision (A) of this subdivision (i), and

(ii) At the end of the taxable year in which the determination is made, the debt-to-equity ratio of the issuing corporation is not greater than 3:1.

For rules relating to the computation of the debt-to-equity ratio, see paragraphs (h) and (j) this section.

(3) *Exception.* Paragraph (f)(2) of this section does not apply to an instrument that evidences a nonrecourse liability.

(4) *Local commercial bank.* The term "local commercial bank" includes any commercial bank at which the issuing corporation ordinarily does business.

(5) *Illustrations.* The following examples illustrate the application of this paragraph (f):

Example (1). Individual A is the sole shareholder of corporation X. On January 1, 1990, A lends $100,000 to X in exchange for a 10 percent note. At about the same time, a local commercial bank lends $100,000 to X in exchange for a 10-percent note with approximately the same terms. The bank loan is personally guaranteed by A. However, the guarantee is required pursuant to the bank's normal lending practice as a substitue for detailed covenants, and the bank loan was made principally on X's credit (and not A's). Based on these facts, 10 percent is a reasonable rate of interest.

Example (2). A is the sole shareholder of corporation X. On July 1, 1989, A lends $100,000 to X in exchange for a 10-year note bearing annual interest at 10 percent. On December 31, 1989, X's debt-to-equity ratio, computed in accordance with the principles of paragraphs (h) and (j) of this section, is 3:1. On July 1, 1989, the section 6621 rate is 12 percent; the prime rate is 14 percent; the endpoints of the range of rates set forth in §1.482-2(a)(2)(iii)(B)(*1*) are 11 percent and 13 percent and the rate determined by the Secretary for 10-year instruments taking into consideration the average yield on outstanding U.S. obligations of comparable maturity is 10 percent. Based on these facts, the rate of interest on the note is considered to be reasonable.

(6) *Cross-reference.* For circumstances where the Commissioner may disregard a noncommercial term of an instrument in determining a reasonable interest rate, see §1.385-3(a)(1)(iii).

(g) *Excessive debt*—(1) *In general.* If, immediately after an instrument is issued by a corporation—

(i) This section applies to the instrument, and

(ii) The corporation's debt is excessive,

then the instrument is treated as stock.

(2) *Excessive debt.* The corporation's debt is "excessive" if (i) all of the instrument's terms and conditions (including the stated interest rate), considered as a whole, and (ii) the corporation's financial structure, taken together, would not be satisfactory to an independent creditor (determined without regard to paragraph (b)(2) of this section). For this purpose, the corporation's size, industry, geographic location, and financial condition must be taken into account. Also, for this purpose, the stated interest rate will be considered satisfactory to an independent creditor if an interest rate one point higher or one point lower than the stated interest rate would be satisfactory to such creditor.

(3) *Safe harbor.* Notwithstanding paragraph (g)(1) of this section, a corporation's debt is not excessive if—

(i) The corporation's outside ratio is less than or equal to 10:1, and

(ii) The corporation's inside ratio is less than or equal to 3:1.

(4) *Ratios.* The corporation's outside ratio is the debt-to-equity ratio determined under paragraphs (h) and (j) of this section. Its inside ratio is determined in the same manner by excluding liabilities to independent creditors (except in computing stockholders' equity). Both ratios are determined at the end of the taxable year in which the instrument is issued.

(5) *Exception.* This paragraph (g) does not apply to instruments issued in exchange for an equal or greater principal amount of indebtedness. For purposes of the preceding sentence, the principal amount of indebtedness includes interest accrued but unpaid up until the date of the exchange, but only to the extent that such interest is paid with principal in the exchange.

(6) *Illustrations.* The following example illustrates the application of this paragraph (g):

Example. Individual B forms corporation Y on December 31, 1982. Y uses the calendar year as the taxable year. On December 31, 1982, Y acquires rental property from an unrelated third party for $100,000. It obtains the $100,000 from the following sources: $10,000 from B for common stock, $10,000 from C on a second mortgage note, and $80,000 from D on a first mortgage note. Assume that C and D are B's father and mother. Also assume that the terms and conditions of the mortgage notes and Y's financial structure would be satisfactory to an unrelated commercial bank. Based on these facts, the mortgage notes are not treated as stock under this paragraph (g).

(h) *Debt-to-equity ratio.* The following rules apply for purposes of the regulations under section 385:

(1) *In general.* The debt-to-equity ratio of a corporation is the ratio that—

(i) The corporation's liabilities (excluding trade accounts payable, accrued operating expenses and taxes, and other similar items) bears to

(ii) The stockholders' equity.

(2) *Stockholders' equity.* The stockholders' equity in a corporation is the excess of—

(i) The adjusted basis of its assets (less reserves for bad debts, if applicable, and other similar asset offsets) over

(ii) Its liabilities (including liabilities excluded under paragraph (h)(1)(i) of this section).

(3) *Operating rules.* Except as provided in paragraph (h)(6) of this section, the adjusted basis of a corporation's assets and the amount of its liabilities are determined—

(i) In accordance with the tax accounting principles properly used by the corporation in determining taxable income; and

(ii) Without regard to the treatment of any interest as stock or indebtedness by reason of section 385.

(4) *Coordination with excessive or inadequate consideration rules.* For purposes of meeting the requirements of paragraph (f)(2) of this section (relating to the interest rate rule of convenience) and the requirements of paragraph (g)(3) of this section (relating to the excessive debt safe harbor), the debt-to-equity ratio of the corporation will be determined without application of the provisions of paragraph (c) of this section.

(5) *Illustrations.* The following examples illustrate the application of paragraph (h)(1)(4) of this section:

Example (1). On December 31, 1990, corporation M has assets with an adjusted basis of $150,000 and liabilities of $100,000. The stockholders' equity in M is $50,000 (*i.e.*, $150,000 - $100,000). Assume that M has no trade accounts payable, accrued taxes and operating expenses, etc., and that the special rules in paragraph (h)(6) of this section do not apply. Based on these facts, the debt-to-equity ratio of corporation M on December 31, 1990 is 2:1 (*i.e.*, $100,000:$50,000).

Example (2). On December 31, 1990, corporation N has assets with an adjusted basis of $150,000. In addition, N has liabilities of $100,000, including $30,000 of trade accounts payable, accrued taxes and operating expenses, etc. The stockholders' equity in N is $50,000 (*i.e.*, $150,000 - $100,000). Assume that the special rules in paragraph (h)(6) of this section do not apply. Based on these facts, N has a debt-to-equity ratio on December 31, 1990 of 7:5 (*i.e.*, $70,000:$50,000).

(6) *Special rules.* (i)(A) In computing the adjusted basis of property of a character subject to the allowance for depreciation for purposes of this section, the deductions for depreciation shall be determined in the same manner as under section 312(k) for purposes of computing earnings and profits.

(B) The following example illustrates the application of this subdivision (i):

Example. Corporation X purchases a new machine for $240,000 and places it in service on January 1, 1983. Assume the machine is "5-year property" within the meaning of section 168(c)(2)(B). Also assume that, under section 312(k)(3)(A), the adjustment to earnings and profits for depreciation with respect to the machine is computed under the straight-line method using a half-year convention and no salvage value and using a recovery period of 12 years. Based on these facts, for purposes of computing X's debt-to-equity ratio on December 31, 1984, X is treated as having an adjusted basis of $210,000 in the machine ($240,000 - ($\frac{1}{8}$) ($240,000)).

(ii) In the case of a corporation that uses the cash method of accounting, the adjusted basis of trade accounts receivable shall be deemed to be equal to the face amount of the receivables (less an appropriate reserve for uncollectibles).

(iii)(A) In determining the debt-to-equity ratio of a corporation at the end of a taxable year, the stockholders' equity shall be increased by the amount of any net operating loss (determined without regard to sections 1211(a) and 1212) sustained by the corporation during the taxable year.

(B) The following example illustrates the application of this subdivision (iii):

Example. On January 1, 1985, individual A organizes corporation T and transfers $100,000 to it for $50,000 of stock and a $50,000 note. At the end of T's first taxable year, T has assets with an adjusted basis of $120,000 and liabilities of $80,000 including $30,000 of trade accounts payable, accrued taxes and operating expenses, etc. T also has a net operating loss (determined without regard to sections 1211(a) and 1212) for the taxable year of $10,000. Based on these facts, T's stockholders' equity at the end of the taxable year is $50,000 (*i.e.*, ($120,000 - $80,000) + $10,000). Consequently, T's debt-to-equity ratio is 1:1 (*i.e.*, $50,000:$50,000).

(iv) In determining the debt-to-equity ratio of a corporation that is a bank (as defined in section 581) or is primarily engaged in a lending or finance business (as defined in section 279(c)(5)), adjustments shall be made in accordance with the principles of section 279(c)(5)(A).

(v) In determining the debt-to-equity ratio of an insurance company (as defined in §1.801-1(b)), insurance reserves shall be treated in the same manner as trade accounts payable.

(vi) A liability is treated in the same manner as a trade account payable if it is—

(A) Incurred under a commercial financing agreement (such as an automobile "floorplan" agreement) to buy an item of inventory,

(B) Secured by the item, and

(C) Due on (or before) sale of the item.

(vii)(A) The debt-to-equity ratio shall be computed without regard to distortions created by a temporary contribution to equity or any similar contrivance.

(B) The following example illustrates the application of this subdivision (vii):

Example. Individual A organizes corporation X on December 31, 1985. X uses the calendar year as the taxable year. A contributes $100,000 in cash and property with a basis of $40,000 to X in exchange for 1,000 shares of common stock and a 10-percent note worth $40,000. On January 4, 1986, X redeems 900 shares of stock for $90,000 in cash. Based on these facts, X's debt-to-equity ratio on December 31, 1985 is determined by not treating the $90,000 paid in redemption of stock on January 4, 1986 as an asset of X. Therefore, the debt-to-equity ratio is 4:1 (*i.e.*, $40,000: $10,000).

(viii) In determining the debt-to-equity ratio of a cooperative, interests described in §1.385-1(b)(2) will be treated as equity except that, if a cooperative treats such an interest as a liability for financial reporting purposes, that interest is treated in the same manner as a trade account payable.

(i) [Reserved]

(j) *Affiliated groups*—(1) *In general.* For purposes of the regulations under section 385, the debt-to-equity ratio of a member of an affiliated group of corporations is determined in accordance with paragraph (h) of this section and this paragraph (j)(1). For purposes of this paragraph (j), the term "affiliated group of corporations" will have the same meaning as in section 1504(a) except that no exclusions will be made under section 1504(b). If one includible corporation ("X") owns stock in another includible corporation ("Y"), then X's debt-to-equity ratio is determined as follows:

(i) X is treated as having a ratable share of Y's assets and liabilities. This ratable share is determined by dividing—

(A) The fair market value of the Y stock owned by X, by

(B) The fair market value of all of Y's stock.

(ii) X's investments in Y and Y's liabilities to X are eliminated. In addition, any other duplication in the amount of X's money and other assets and liabilities resulting from the application of this subparagraph (1) (for example, resulting from Y's ownership of stock in X) is eliminated.

(2) *Illustrations*. The following examples illustrate the application of this paragraph (j):

Example (1). Corporations P and S-1 comprise an affiliated group, P owning all the stock of S-1. On December 31, 1985, P's only asset is stock in S-1, and P has no liabilities. In addition, S-1 has assets with an adjusted basis of $200,000 and liabilities of $150,000. Assume that S-1 has no trade accounts payable, accrued taxes and operating expenses, etc. and that the special rules in paragraph (h)(6) of this section do not apply. Based on these facts, P is treated as having assets with an adjusted basis of $200,000 and liabilities of $150,000. Therefore, P's debt-to-equity ratio is 3:1 (*i.e.*, $150,000:$50,000).

Example (2). The facts are the same as in example (1), except that S-1's liabilities include a $50,000 note payable to P and P's assets consist of this note and the S-1 stock. Eliminating this note, S-1's liabilities are only $100,000. Based on these facts, P is treated as having liabilities of $100,000 and assets with an adjusted basis of $200,000. Therefore, P's debt-to-equity ratio is 1:1 (*i.e.*, $100,000:$100,000).

Example (3). (a) The facts are the same as in example (1), except that S-1's assets include 80 percent of the only class of stock of corporation S-2, which also is a member of the affiliated group. S-1's adjusted basis in the stock of S-2 is $15,000. In addition, S-2 has assets with an adjusted basis of $50,000 and no liabilities.

(b) Based on these facts, S-1 is treated as having $40,000 (*i.e.*, 80 percent of $50,000) of S-2's assets instead of the S-2 stock. Therefore, S-1 is treated as having assets with an adjusted basis of $225,000 and liabilities of $150,000. Thus, S-1's debt-to-equity ratio is 2:1 (*i.e.*, $150,000:$75,000). P's debt-to-equity ratio is also 2:1.

Example (4). Corporations W X, Y, and Z comprise an affiliated group. W owns all of the stock of X and X owns all of the stock of each of Y and Z. In addition to the stock of Y and Z, X has assets with an adjusted basis of $100 and no liabilities. Y has assets with an adjusted basis of $800 and liabilities of $700. These liabilities include a liability of $200 to W and a liability of $100 to Z. Z has, in addition to its obligation from Y, assets with an adjusted basis of $300 and liabilities of $200. Assume that X, Y, and Z have no trade accounts payable, accrued taxes and operating expenses, etc. and that the special rules in paragraph (h)(6) of this section do not apply. Based on these facts, for the purpose of computing X's debt-to-equity ratio, X is treated as having Y's assets with an adjusted basis of $800 and Y's liabilities of $600 (the liability of Y to Z is eliminated for this purpose but the liability to W is not). Also, for this purpose, X is treated as having Z's assets with an adjusted basis of $300 and Z's liabilities of $200 (Z's obligation from Y is eliminated for this purpose). Therefore, X is treated as having assets with an adjusted basis of $1,200 and liabilities of $800 and X's debt-to-equity ratio is 2:1.

(k) *Change in terms*—(1) *In general*. If—

(i) The holder agrees to postpone the maturity date or otherwise to make a substantial change in the terms of an instrument,

(ii) The instrument is treated as indebtedness under the regulations under section 385, and

(iii) This section applies to the instrument on the day of agreement,

then (for purposes of the regulations under section 385) the instrument is treated as newly issued in exchange for property on the day of agreement. Thus, beginning on the day of agreement the instrument may be treated as stock under paragraph (d) of this section (relating to hybrid instruments), paragraph (e) of this section (relating to certain instruments not issued for money) or paragraph (m) of this section (relating to instruments payable on demand). However, paragraph (g) of this section (relating to excessive debt) does not apply unless there is an increase in the principal amount of the instrument within the meaning of paragraph (g)(5) of this section.

(2) *Substantial*. For purposes of this paragraph (k), each change in the terms of an instrument is substantial if the fair market value of the instrument could be materially affected by that change. Thus, for example, subordination (however effected) or a change in interest rate is ordinarily a substantial change. On the other hand, a mere substitution of collateral need not be a substantial change. In addition, prepayment will not be considered a substantial change in terms.

(3) *Day of agreement*. For purposes of this paragraph (k), the "day of agreement" is the day the issuer and the holder enter into a binding contract to change the terms of an instrument.

(4) *Illustrations*. The following examples illustrate the application of this paragraph (k):

Example (1). A is the sole shareholder of corporation X. On January 1, 1990, X issues a $10,000, 9-percent note to A for $10,000 in cash. The note is due on January 1, 2000, and is treated as indebtedness under §1.385-4(a). However, on December 10, 1999, A and X agree to extend the maturity of the note until January 1, 2015. Assume that under the terms of the agreement the note will continue to pay 9-percent interest, and that on December 10, 1999, 9-percent is not a reasonable rate of interest (within the meaning of paragraph (f) of this section) for a note due on January 1, 2015. Also assume that an independent creditor holding the note would not, in the exercise of ordinary diligence, have agreed to the extension of maturity and that, therefore, the exception of paragraph (e)(3) of this section is not applicable. Based on these facts, the note would be treated as stock under paragraph (e) of this section if it were newly issued in exchange for property on December 10, 1999. Therefore, the note is reclassified as stock on December 10, 1999.

Example (2). A is the sole shareholder of corporation X. X issues a $20,000, 10-percent note to A for $20,000 in cash on January 1, 2005. The note is due on January 1, 2007, and is treated as indebtedness under §1.385-4(a). On December 10, 2005, A and X agree to extend the maturity of the note until January 1, 2037, and to increase the interest rate from 10 to 11 percent. For purposes of this paragraph (k), both changes in terms made on December 10, 2005 are substantial because both could materially affect the fair market value of the note. The result is the same even if the two changes are mutually offsetting in the sense that, taken together, they have no material effect on the fair market value of the note.

Example (3). B is the sole shareholder of corporation Y. On January 1, 1990, Y issues a $30,000, 10-percent note to B in exchange for $30,000. The note is due on January 1, 2000 and is treated as indebtedness under §1.385-4(a). Interest on the note is paid according to its terms through 1999. During 1999, Y encounters business difficulties. On December 11, 1999, B agrees to extend the note until January 1, 2002 and also agrees to subordinate the note to a new bank loan being made at this time. Based on these facts, the note is treated (for purposes of the regulations under section 385) as newly issued in exchange for an equal principal amount of indebtedness. Assume that an independent creditor holding the note would, in the exercise of ordinary diligence, have agreed to both the extension of maturity and the subordination to the new bank loan. Assume also that Y would, in the exercise of ordinary diligence, have agreed to the extension and the subordination even if the note were held by an independent creditor. Based on these additional facts, the note continues to be treated as indebtedness notwithstanding the extension of maturity and the subordination to the new bank loan. See paragraph (e)(3) and example (4) of paragraph (e)(4) of this section. However, the note continues to be subject to this paragraph (k) and to paragraphs (l) and (m) of this section.

(l) *Nonpayment of interest*—(1) *In general.* If—

(i) A corporation fails to pay all or part of the interest due and payable on an instrument during a taxable year,

(ii) This section applies to the instrument on the last day of the taxable year, and

(iii) The owner of the instrument fails to exercise the ordinary diligence of an independent creditor,

then the instrument is treated as stock beginning on the later of the first day of the taxable year during which the failure to pay occurs or the first day on which this section applied to the instrument.

(2) *Illustrations.* The following examples illustrate the application of paragraph (l)(1) of this section:

Example (1). N is the sole shareholder of corporation Y. On January 1, 1986, Y issues $100,000 of 10-year, 10-percent debentures. Interest on the debentures is payable semiannually. Eighty thousand dollars of the debentures are issued to N and are treated as indebtedness under §1.385-4(a). The remaining debentures are issued to independent creditors. Y pays all interest accrued on the debentures semiannually until 1991. Because of adverse business conditions, Y does not pay the interest accrued in 1991 on either the debentures held by N or the debentures held by the independent creditors. Both N and the independent creditors decide not to bring suit against Y in the hope that conditions will improve and that Y will be able to meet its obligations. Based on these facts, the debentures held by N continue to be treated as indebtedness because N has not failed to exercise the ordinary diligence of an independent creditor.

Example (2). (a) M is the sole shareholder of X, a corporation that uses the calendar year as the taxable year. On January 1, 1985, X issues $100,000 of 10-year, 9-percent debentures. Interest on the debentures is payable semiannually. Ten thousand dollars of the debentures are issued to M and are treated as indebtedness under §1.385-4(a). The remaining debentures are issued to independent creditors. X pays all interest accrued on the debentures semiannually until 1990. Because of adverse business conditions, X does not pay the interest accrued in 1990 on the debentures held by M. However, X continues to pay interest on the debentures held by the independent creditors. Based on these facts, the debentures held by M are treated as a separate class of instruments beginning on January 1, 1990. See paragraph (a)(5) of this section. Since the debentures held by M are treated as a separate class of instruments, the holdings of M's debentures and the stock of X are substantially proportionate as of January 1, 1990.

(b) M has failed to take the steps that a reasonably diligent independent creditor would take to secure payment of interest. Based on these facts, the debentures held by M are treated as stock beginning on January 1, 1990. However, the debentures held by the independent creditors are not affected.

Example (3). L owns 80 percent of the stock of Z, a corporation that uses the calendar year as the taxable year. On January 1, 1985, Z issues $200,000 of 10-year, 10-percent unsecured notes to L. Interest on the notes is payable semiannually. Z pays all interest accrued on the notes semiannually until 1990. Because of adverse business conditions, Z does not pay the interest accrued in 1990 on the notes. On February 1, 1991, L agrees to postpone $10,000 of the interest accrued in 1990 until the notes mature on January 1, 1995. In addition, Z agrees to pledge certain collateral as security for the debentures. Taking into account Z's prior record of paying all interest accrued until 1990, the pledge of collateral, and all other relevant facts and circumstances, it is assumed that L has exercised the ordinary diligence of an independent creditor. Based on these facts, the notes continue to be treated as indebtedness.

(3) *Failure to pay interest.* For purposes of this section, a corporation fails to pay interest on an instrument during a taxable year of the corporation if the interest is not actually paid within 90 days after the end of such taxable year. For this purpose, payment of interest with property other than money will be considered actual payment, but only to the extent such property is includible in the income of the holder of the instrument. For example, payment of interest with a note will be considered actual payment, but only to the extent the note is includible in the income of the holder of the note. For this purpose, property is considered to be includible in the income of a tax-exempt entity (*e.g.*, a charitable organization) if it would be includible if the entity were not tax-exempt.

(4) *Special rule.* (i) For purposes of this paragraph (l), interest accrued while this section does not apply to the instrument is disregarded.

(ii) The following example illustrates the application of this subparagraph (4):

Example. Individual A owns all the stock of X, a corporation that uses the calendar year as the taxable year. On January 1, 1985, X issues $10,000 of 8-percent debentures to B, an independent creditor. The debentures are treated as indebtedness under §1.385-4(a) (relating to instruments generally). Interest on the debentures is payable semiannually on January 1 and July 1 of each year. X fails to make the $400 payment of interest due on July 1, 1986, and A then buys the debentures from B. X actually pays the $400 interest due on January 1, 1987, but A forgives the $400 payment that was due on July 1, 1986. Based on these facts, the debentures are not treated as stock under this paragraph (l). There is no requirement that interest accrued while B held the debentures must be paid. However, X may have income under §1.61-12(a) (relating to discharge of indebtedness).

(m) *Payable on demand*—(1) *Initial classification.* If immediately after it is issued—

(i) This section applies to an instrument,

(ii) By its terms, the instrument i
payable on demand, and

(iii) The stated annual rate of interest on the instrument is not reasonable (within the meaning of paragraph (f) of this section),

then the instrument is treated as stock.

(2) *Reclassification.* If for any taxable year (or portion thereof)—

(i) Either by its terms or by operation of paragraph (m)(3) of this section, an instrument is payable on demand,

(ii) This section applies to the instrument, and

(iii) The issuing corporation fails to pay interest on the instrument at a reasonable rate,

then the instrument is treated as stock beginning on the first day of that taxable year (or portion thereof). For purposes of this subparagraph (2), a rate of interest is considered reasonable if it is reasonable (within the meaning of paragraph (f) of this section) as of any day of the taxable year.

(3) *Nonpayment of principal.* If—

(i) The issuing corporation fails to make a scheduled payment of principal on an instrument within 90 days after the payment is due, and

(ii) The holder of the instrument fails to exercise the ordinary diligence of an independent creditor,

then, for purposes of this paragraph (m), the instrument is considered to be payable on demand beginning on the day after the day the principal is due.

(4) *Exceptions.* (i) This paragraph (m) (other than subparagraph (4)(ii) thereof) does not apply to an instrument that is actually retired within 120 days after the end of the taxable year of issue.

(ii) If an instrument payable on demand described in paragraph (m)(4)(i) of this section is not retired with interest at an arm's length rate within the meaning of §1.428-2(a)(2), then interest at the rate set forth in §1.482-2(a)(2)(iii)(B)(*2*) shall be imputed.

(iii) For purposes of paragraph (m)(4)(i) of this section, an instrument is not considered to be actually retired if it is reissued, renewed or offset i
any manner. An instrument will b
presumed not to be reissued, renewe

or offset to the extent that the holder (or any person from whom the ownership of stock would be attributed to the holder under section 318(a)) does not make any loan described in §1.385-7(a)(1) within the prohibited period and the corporation does not issue to the holder (or to any such person) an instrument payable on demand within the prohibited period. The prohibited period begins on the date the instrument is retired and extends for the number of days the instrument was outstanding. The Commissioner may rebut this presumption by evidence tending to show that the instrument, when considered with other loans or instruments, is used for purposes other than temporary and nonperiodic needs of the corporation's business. For example, this presumption may be rebutted by evidence tending to show that the corporation has a seasonal need for working capital and that there is a pattern of funding this need with instruments payable on demand or loans described in §1.385-7(a).

(iv)(A) If a failure to pay interest on an instrument at a reasonable rate results solely from a failure to pay interest when due, then paragraph (m)(2) of this section does not apply. See, however, paragraph (l) of this section (relating to nonpayment of interest when due).

(B) The following example illustrates the application of this subdivision (iv):

Example. Individual A owns 100 percent of the stock of corporation X. On January 1, 1990, X issues a 14-percent demand note to A. X uses the calendar year as its taxable year. Assume that 14 percent is a reasonable rate of interest (within the meaning of paragraph (f) of this section) on January 1, 1990, but that X fails to pay any part of the interest due on the note for the taxable year 1990. Based on these facts, paragraph (m)(2) of this section does not apply. However, if A has failed to exercise the ordinary diligence of an independent creditor, the note will be treated as stock under paragraph (l) of this section.

(5) Illustrations. The following examples illustrate the application of this paragraph (m) and related provisions. It is assumed in these examples, that the demand instruments are not retired within 120 days after the end of the taxable year in which they are issued:

Example (1). J and N operate a partnership that distributes beer. On April 1, 1989, J and N organize corporation T and transfer the assets of the partnership to the corporation. In exchange for the assets of the partnership, J and N each receive half of the common stock of T and an 8-percent demand note for $45,000. Assume that 8 percent is not a reasonable rate of interest (within the meaning of paragraph (f) of this section) on April 1, 1989. Based on these facts, the demand notes are treated as stock.

Example (2). On August 24, 1986, F organizes corporation G to own and operate an outdoor amusement business. G uses the calendar year as its taxable year. On August 25, 1986, F transfers trucking equipment, mechanical rides, and other assets to G in exchange for all the capital stock of G and a 6 percent note for $200,000. The note is due on August 25, 1990, and is classified as indebtedness under §1.385-4(a). However, G does not pay the principal within 90 days after it is due, and F does not pursue such payment with the ordinary diligence of an independent creditor. Based on these facts, beginning on August 26, 1990, the note is considered to be payable on demand. Assume that during 1990 the lowest reasonable rate of interest on a demand note issued by G (taking into account the financial condition of G) is 12 percent a year, and that under applicable local law the note continues to pay 6 percent interest after maturity. Based on these facts, the note is treated as stock on August 26, 1990.

Example (3). The facts are the same as in example (2) except that G agrees to pay 12 percent interest on the note. In addition, assume that 12 percent is a reasonable rate of interest on August 26, 1990. Based on these facts, the note is not treated as stock under this paragraph (m).

Example (4). The facts are the same as in example (3), except that G issues a 12-percent demand note for $200,000 to F in payment for the 6-percent note due on August 25, 1990. Based on these facts, the 6-percent note is not treated as stock. In addition, the 12-percent note may be treated an indebtedness under §1.385-4(a).

(n) *Meaning of terms*—(1) *Debt-to-equity ratio*. For the definition of the term "debt-to-equity ratio", see paragraphs (h) and (j) of this section.

(2) *Failure to pay interest*. For the definition of the term "failure to pay interest," see paragraph (l)(3) of this section.

(3) *Fair market value*. For the definition of the term "fair market value", see §1.385-3(a).

(4) *Instrument*. For the definition of the term "instrument", see §1.385-3(b).

§1.385-7 Certain other obligations.

(a) *Scope*—(1) *In general*. This section applies to any loan of money (*e.g.*, a cash advance) made to a corporation unless—

(i) the loan is made by an independent creditor (within the meaning of §1.385-6(b)), or

(ii) the loan is evidenced by an instrument within 120 days after the end of the taxable year in which the loan is made.

If the loan is evidenced by an instrument within 120 days after the end of the taxable year in which the loan is made, the instrument is considered to be issued in consideration of the loan. For treatment of the instrument as stock or indebtedness, see §§1.385-4 through 1.385-6.

(2) *Exceptions*. (i) This section (other than paragraph (a)(2)(ii) thereof) does not apply to a loan repaid within 120 days after the end of the taxable year in which the loan is made.

(ii) If a loan described in paragraph (a)(2)(i) of this section is not repaid with interest at an arm's length rate within the meaning of §1.482-2(a)(2), then interest at the rate set forth in §1.482-2(a)(2)(iii)(B)(*2*) shall be imputed.

(iii) For purposes of paragraph (a)(2)(i) of this section, a loan is not considered to be actually repaid if it is renewed or offset in any manner. A loan will be presumed not to be renewed or offset to the extent that the lender (or any person from whom the ownership of stock would be attributed to the lender under section 318(a)) does not make any loan described in paragraph (a)(1) of this section within the prohibited period and the corporation does not issue to the lender (or such person) an instrument payable on demand within the prohibited period. The prohibited period begins on the day the loan is repaid and extends for the number of days the loan was outstanding. The Commissioner may rebut this presumption by evidence tending to show that the loan, when considered with other loans or instruments, is used for purposes other than temporary and nonperiodic needs of the corporation's business. For example, this presumption may be rebutted by evidence tending to show that the corporation has a seasonal need for working capital and that there is a pattern of funding this need with loans described in paragraph (a)(1) of this section.

(b) *Initial classification*—(1) *In general*. Except as provided in paragraph (b)(2) of this section, a loan to which this section applies is treated as indebtedness.

(2) *Exception*. A loan to which this section applies is treated as a contribution to capital if the debtor corporation has excessive debt when the loan is

made (under the principles of §1.385-6(g)).

(c) *Reclassification*—(1) *In general.* If a loan is treated as indebtedness under paragraph (b)(1) of this section and if the debtor corporation fails to pay interest on the loan at a reasonable rate during any taxable year, then the loan is reclassified as a contribution to capital as of the later of the first day of the taxable year or the date of the loan. For purposes of this subparagraph (1), a rate is considered reasonable if it is reasonable (under the principles of §1.385-6(f)) as of any day of the taxable year.

(2) *Special rule.* For purposes of paragraph (c)(1) of this section, a corporation is not considered to pay interest on a loan during a taxable year unless the interest is actually paid within 90 days after the end of such taxable year. For this purpose, payment of interest with property other than money will be considered actual payment, but only to the extent such property is includible in the income of the lender. For example, payment of interest with a note will be considered actual payment, but only to the extent such note is includible in the income of the lender. For this purpose, property is considered to be includible in the income of a tax-exempt entity (*e.g.*, a charitable organization) if it would be includible if the entity were not tax-exempt.

(d) *Effect of this section*—(1) *Initial classification.* If a loan is treated as a contribution to capital under paragraph (b)(2) of this section, then all payments of principal and interest on the loan are treated as distributions to which section 301 applies.

(2) *Reclassification.* If a loan is reclassified as a contribution to capital under paragraph (c) of this section, then all payments of principal and interest made on the loan after the beginning of the year of reclassification are treated as distributions to which section 301 applies. In addition, once a loan is reclassified under paragraph (c) of this section, its status as a contribution to capital can never change.

(e) *Illustrations.* The following examples illustrate the application of this section:

Example (1). Corporation M uses the calendar year as the taxable year. A is the sole shareholder of M. On March 1, 1986, A advances $75,000 to M, and M establishes an account payable to A in the amount of $75,000. The account payable is entered on the books of M but is not evidenced by an instrument. The account payable is not repaid within 120 days after the end of 1986. In addition, M has excessive debt within the meaning of §1.385-6(g). Based on these facts, the account payable is classified as a contribution to capital.

Example (2). The facts are the same as in example (1), except that M does not have excessive debt. The account payable is classified as indebtedness. However, if M fails to pay (before April 1, 1987) interest at a reasonable rate on the account payable for the last 10 months of 1986, the account payable will be reclassified as a contribution to capital (effective retroactively to March 1, 1986).

Example (3). Corporation X, which has excessive debt, uses the calendar year as the taxable year. On January 1, 1985, X's sole shareholder advances $60,000 to X. The advance is entered on the books of X but is not evidenced by an instrument. X repays $40,000 of the advance on April 1, 1985 and the remaining $20,000 on October 1, 1986. The advance is not renewed or offset in any manner. Based on these facts, this section (other than paragraph (a)(2)(ii) thereof) does not apply to the $40,000 of the advance that was repaid on April 1, 1985. See paragraph (a)(2)(i) of this section. The remaining $20,000 is treated as a contribution to capital. Therefore, the $20,000 repaid on October 1, 1986 is treated as a distribution to which section 301 applies. Also, interest on the $40,000 repaid on April 1 is imputed at the rate set forth in §1.482-2(a)(2)(iii)(B)(*2*).

Example (4). B is the sole shareholder of corporation Y. On June 1, 1988, B makes a $40,000 noninterest-bearing unwritten advance to Y. The advance is repaid on November 30, 1988 and is not renewed or offset in any manner. Based on these facts, interest is imputed on the advance at the rate set forth in §1.482-2(a)(2)(iii)(B)(*2*). Assume that the rate set forth in §1.482-2(a)(2)(iii)(B)(*2*) is 12 percent per annum simple interest. Then $2,400 is imputed with respect to the period of the advance as interest income to B and as an interest expense of Y. However, apart from this imputation of interest, this section does not apply to the advance.

Example (5). Corporations S and T are wholly owned subsidiaries of corporation P. P, S, and T use the calendar year as their taxable year. On July 1, 1990, S makes a noninterest bearing advance of $50,000 to T. The advance is entered on the books of T but it is not evidenced by an instrument. The advance is not repaid within 120 days after the end of 1990. Based on these facts, S is treated as distributing $50,000 to P, and P is then treated as contributing this amount to the capital of T.

§1.385-8 Locked interests.

(a) *In general.* For purposes of the regulations under section 385, two or more distinct interests in a corporation are treated as separate even though title to one cannot be transferred without transferring title to the others. Thus, for example, if a corporation issues a bond with a nondetachable warrant, the bond and the warrant are treated as two separate interests in the corporation.

(b) *Illustrations.* The following e
amples illustrate the application
this section:

Example (1). On January 1, 1989, corpo
tion X issues 20-year, $1,000 debentures w
nondetachable warrants. Each warrant entit
the holder to buy 100 shares of common stock
X for $10 a share. Based on these facts, the
bentures and the warrants are treated as se
rate interests.

Example (2). The facts are the same as in
ample (1), except that each debenture can
surrendered on the exercise of a warrant in l
of cash. The result is the same as in example (
Example (3). On January 1, 1990, corpo
tion Y issues a 25-year, $1,000 debenture to
dividual A for $1,000 in cash. Y has no other
bentures outstanding. The debenture pays in
est at a rate of $100 a year; $50 is payable in
events and the other $50 is noncumulative
payable only if earned. Individual A owns
percent of the stock in Y, and the fair mar
value of the debenture is $1,000. Based on th
facts, the debenture is treated as stock un
§1.385-6(d) (relating to hybrid instruments h
proportionately).

Example (4). The facts are the same as in
ample (3), except that Y issues a $600 debent
together with four shares of preferred stock to
The debenture pays fixed interest of $50 a y
and has a fair market value of $600. Each sh
of preferred stock has a liquidation value
$100 and pays a noncumulative dividend
$12.50 a year if earned. In addition, Y is
quired to redeem the preferred stock at $10
share at the end of 25 years. Assume t
§1.385-6(g) (relating to excessive debt) does
apply to the debenture. Based on these facts,
debenture is treated as indebtedness un
§1.385-4(a). The result is the same even i
cannot transfer title to the debenture with
also transferring title to the preferred stock.

Par. 4. Section 15A.453-1(c)(8)
amended to read as follows:

§15A.453-1 Installment method
porting for sales of real prope
and casual sales of personal prop
ty.

* * * * *

(c) ***

(8) *Coordination with section 3*
For rules regarding coordination w
section 385, see §1.385-1(b)(4).

Par. 5. Paragraph (a)(4)(ii)
§1.482-2 is amended by deleti
"§1.61-12(c)(2)" and inserting in l
thereof "section 171."

Par. 6. Paragraph (a)(5) of §1.4
2 is amended by adding, immedia
after the first sentence in the flush
terial following (ii), "(See, howe
§1.385-6(f)(2), under which the
haven rates of paragraph (a)(2)(iii
this section may, under certain
cumstances, be safe harbor rates
der the regulations under sec
385.)"

Par. 7. The example in §1.
2(a)(6) is amended:

1. By deleting "(see §1.385-3(a)(1))" from the fourth sentence and inserting in lieu thereof "(see §1.385-6(c)(1))"; and

2. By inserting immediately after the second sentence, "Assume that S's debt-to-equity ratio, determined under §1.385-6(h) and (j), exceeds 3:1 on the last day of the taxable year of issue."

ROSCOE L. EGGER, JR.,
Commissioner of
Internal Revenue.

(Filed by the Office of the Federal Register on December 30, 1981, 3:04 p.m., and published in the issue of the Federal Register for January 5, 1982, 47 F.R. 164.)

Notice of Proposed Rulemaking

Disclosures of Return Information to Officers and Employees of Bureaus of the Census and Economic Analysis and To Designee of Taxpayer

LR-111-81

SUMMARY: This document contains proposed amendments to regulations relating to disclosures of return information to officers and employees of the Bureaus of the Census and Economic Analysis of the Department of Commerce for certain statistical purposes. These regulations affect disclosures of return information under section 6103(j)(1) of the Internal Revenue Code of 1954 and provide Internal Revenue Service and Social Security Administration personnel and other persons with the guidance needed to comply with the law. In addition, an amendment to the regulations is proposed to permit the Service to authorize other Federal agencies to which returns and return information have been disclosed by the Internal Revenue Service to further disclose such returns and return information to the taxpayer's designee.

DATES: Written comments and requests for a public hearing must be delivered or mailed by March 8, 1982. The amendments are proposed to be effective with respect to disclosures of return information made after the date of publication of these amendments as a Treasury decision.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-111-81), Washington, D.C., 20224.

FOR FURTHER INFORMATION CONTACT: David E. Dickinson of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3373, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Regulations on Procedure and Administration (26 CFR Part 301) under section 6103(j)(1) and (p)(2)(B) and are issued under the authority of sections 6103 (j)(1) and (q) and 7805 of the Internal Revenue Code of 1954 (90 Stat. 1678 and 1685, 68A Stat. 917; 26 U.S.C. 6103(j)(1) and (q), 7805).

PROVISIONS OF THE REGULATIONS

The Internal Revenue Service has been requested to amend §301.6103 (j)(1)-1(b) of the Regulations on Procedure and Administration to provide for the disclosure to the Census Bureau of additional items of return information for purposes of conducting the 1982 economic and agricultural censuses. These additional items relate principally to cost of goods sold, royalty and farm income, and receipts of exempt organizations reported on Form 990. Also §301.6103(j)(1)-1(b)(4) would be amended to permit the additional disclosure of business related employment codes and service center, district and area office codes.

Further, the Census Bureau has reviewed the various items of return information presently disclosable under §301.6103(j)(1)-1(b) to determine which, if any, of these items are no longer needed for authorized statistical purposes. As a result of this review, this proposed amendment would delete present disclosure authority with respect to several items, principally having to do with labor hired, number of employees, and taxable wages paid under the Federal Insurance Contribution Act.

Also, the regulations under §301.6103(j)(1)-1(c) are proposed to be amended to permit the Social Security Administration to disclose to the Bureau of Economic Analysis for authorized statistical purposes certain described return information from employment tax returns of corporations.

Finally, in certain instances, returns and return information which the Internal Revenue Service has disclosed to another Federal agency for an authorized purpose may be more readily available from that agency than the Service when yet another person requests the Service to disclose the returns and return information for an authorized purpose. An example would be employment tax returns and return information filed directly with the Social Security Administration for processing purposes as authorized by section 6013(l)(5). When another person requests this data for a purpose authorized by section 6103, it may be more feasible for the Social Security Administration to make the disclosure rather than the Service. For this reason, §301.6103(p)(2)(B)-1(a) of present regulations authorizes the use of this mechanism with the Service's consent. The proposed amendment to this regulation would specifically authorize the use of the mechanism where disclosure is to be made to the taxpayer's designee under section 6103(c).

DRAFTING INFORMATION

The principal author of these regulations was David E. Dickinson of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Proposed amendments to the regulations

The proposed amendments to the Regulations on Procedure and Administration (26 CFR Part 301) are as follows:

Paragraph 1. Paragraphs (b)(2)(i), (ii), (iii), and (iv), (b)(3), (b)(5)(ii), and (c) of §301.6103(j)(1)-1 are amended to read as follows:

§301.6103(j)(1)-1 Disclosures of return information to officers and employees of the Department of Commerce for certain statistical purposes and related activities.

* * * *

(b) *Disclosure of return information to officers and employees of the Bureau of the Census.*

* * * *

(2) ***

(i) From the business master files of the Service, the taxpayer name directory and entity records consisting of taxpayer identify information (as defined in section 6103(b)(6)) with respect to taxpayers engaged in a trade or business, the principal industrial activity code, the filing requirement code, the employment code, the service center and district and area office codes, and monthly corrections of, and additions to, such entity records;

(ii) From Form SS-4, all return information reflected on such return;

(iii) From an employment tax return—

(A) Taxpayer identifying number (as described in section 6109) of the employer and any employee identified on such return,

(B) Total compensation reported,

(C) Total number of employees reflected on such return,

(D) Master file tax account number,

(E) Taxable period covered by such return,

(F) Employment code,

(G) Document locator number,

(H) Record code,

(I) Total number of individuals employed in the taxable period covered by the return,

(J) Taxable wages paid for purposes of chapter 21 to each such employee,

(K) Taxable tip income for purposes of chapter 21 reported on the return with respect to each such employee,

(L) Total taxable wages paid for purposes of chapter 21, and

(M) Total taxable tip income reported for purposes of chapter 21; and

(iv) From Form 1040, Schedule SE—

(A) Taxpayer identifying number of self-employed individual,

(B) Business activities subject to the tax imposed by chapter 21,

(C) Net earnings from farming,

(D) Net earnings from nonfarming activities,

(E) Total net earnings from self-employment, and

(F) Taxable self employment income for purposes of chapter 2.

(E) Officers or employees of the Service will disclose the following business related return information reflected on the return of a taxpayer to officers and employees of the Bureau of the Census for purposes of, but only to the extent necessary in, conducting and preparing, as authorized by chapter 5 of Title 13, United States Code, demographic, economic, and agricultural statistics programs and censuses—

(i) From Form 1040, Schedule C, taxpayer identify information (as defined in section 6103(b)(6)), the principal industrial activity code, reported gross receipts, returns and allowances, cost of labor, and salaries and wages;

(ii) From Form 1120F, Section II, and Forms 1065, 1120, 1120S, 990C, and 990T, the taxpayer identifying number (as described in section 6109), the principal industrial activity code, the consolidated return indicator (if any), and reported gross receipts less returns and allowances;

(iii) From Forms 1120, 1120S, and 1065, cost of goods sold, and royalty income;

(iv) From Form 990C, cost of goods sold;

(v) From Form 1040, Schedule F, taxpayer identity information and reported gross profits;

(vi) From Form 1040, Schedule C, and Forms 1065 and 1120S, answers to the business activity questions;

(vii) From Form 1040, Schedule C, business address, answer to the question relating to Form 941, and cost of goods sold and, or, operations;

(viii) From Form 990—

(A) Taxpayer identifying number;

(B) Reported gross receipts;

(C) Cost of goods sold;

(D) Membership dues and assessments; and

(E) Total contributions, gifts, grants, and similar amounts received;

(ix) From Form 990PF, the taxpayer identifying number, the principal industrial activity code, and reported total receipts;

(x) From Form 1065, the names and taxpayer identifying numbers of no more than 10 members of the partnership;

(xi) From Form 1065, including Schedule F, if any, total sales of livestock and produce raised and other farm income and gross and net profits from farming; and

(xii) From Form 1120S, the names and taxpayer identifying numbers of, and the number of shares of stock owned by, no more than 10 shareholders of the corporation.

* * * * *

(5) ***

(ii) From an employment tax return—

(A) Taxpayer identifying number (as described in section 6109) of the employer and any employee identified on such return,

(B) Total compensation reported,

(C) Taxable wages paid for purposes of chapter 21 to each such employee,

(D) Taxable tip income for purposes of chapter 21 reported on the return with respect to each such employee,

(E) Employment code, and

* * * * *

(c) *Disclosure of return information to officers and employees of the Bureau of Economic Analysis*. (1) Officers or employees of the Service will disclose to officers and employees of the Bureau of Economic Analysis for purposes of, but only to the extent necessary in, conducting and preparing, as authorized by law, statistical analyses return information consisting of Statistics of Income transcript-edit sheets containing return information reflected on returns of designated classes or categories of corporations with respect to the tax imposed by chapter 1 and microfilmed records of return information reflected on such returns where needed for further use in connection with such conduct or preparation.

(2) Subject to the requirements of paragraph (d) of this section and §301.6103(p)(2)(B)-1, officers and employees of the Social Security Administration to whom the following return information reflected on returns of designated classes or categories of corporations has been disclosed as pro-

vided by section 6103(l)(1)(A) or (5) may disclose such return information to officers and employees of the Bureau of Economic Analysis for necessary purposes described in subparagraph (1) of this paragraph—

(i) From Form SS-4, principal industrial activity and geographic codes; and

(ii) From an employment tax return—

(A) Total compensation reported, and

(B) Taxable wages paid for purposes of chapter 21 to each employee.

* * * * *

Par. 2. Paragraph (a) of §301.6103(p)(2)(B)-1 is amended by deleting the words "a person described in section 6103(e)" in the first sentence and inserting in lieu thereof the words "to a person described in section 6103(c) or (e)".

ROSCOE L. EGGER, JR.,
Commissioner of
Internal Revenue.

(Filed by the Office of the Federal Register on January 20, 1982, 8:45 a.m., and published in the issue of the Federal Register for January 21, 1982, 47 F.R. 3007)

Notice of Proposed Amendments to the Statement of Procedural Rules

Statement of Procedural Rules

LR-120-81

SUMMARY: This document contains proposed amendments to the Statement of Procedural Rules. The Statement of Procedural Rules sets forth the procedural rules of the Internal Revenue Service for all taxes administered by the Service as well as certain rules that apply to the Bureau of Alcohol, Tobacco, & Firearms. These proposed amendments will allow the Internal Revenue Service to implement a plan to automate its system of maintaining current information concerning authorized representatives of taxpayers. The automated system, called the Centralized Authorization File (CAF) will allow Service personnel to identify quickly representatives and the extent of the authorization, and to send automatically refunds, copies of taxpayer notices, and other communications to authorized representatives.

DATES: Written comments and requests for a public hearing must be delivered or mailed by June 1, 1982. The amendments are proposed to be effective on March 31, 1982.

ADDRESS: Send comments and request for a public hearing to: Commissioner of Internal Revenue, Attention CC:LR:T [LR-120-81], Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Carolyn Swift of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 Attention CC:LR:T (202-566-3458, not a toll-free number).

SUPPLEMENTARY INFORMATION

BACKGROUND

This document contains proposed amendments to the Statement of Procedural Rules (26 CFR Part 601) relating to conference and practice requirements. The proposed amendments will allow the Internal Revenue Service to implement a plan to automate its system of maintaining information regarding authorizations by taxpayers. The proposed amendments are to be issued under the authority contained in 5 U.S.C. §§301 and 552.

For many years, the Internal Revenue Service has employed an essentially manual system for maintaining information regarding taxpayer representatives. The information in these files is necessary to identify which taxpayers have authorized representatives to act in their behalf, to identify the scope of representatives' authority, and to ensure that representatives receive copies of taxpayer notices and other communications from the [Service] concerning their clients. Because of the manual nature of this system, however, it is often difficult to provide data in a complete and timely manner. It was decided, therefore, to implement an automated system of maintaining taxpayer representative information.

The automated system, known as the Centralized Authorization File (CAF), is based on the assignment of an individual number to each representative who files the documents required by §601.502. With one exception, the number assigned to the representative will be a unique number, unrelated to any other previously assigned identification number. (Thus, for example, the number will not be the representative's social security number or employer identification number.) After the CAF has been implemented, representatives will be requested, but not required, to use the assigned number on all correspondence with the Service concerning any taxpayer he or she represents. If the Service determines that a number has not yet been assigned to a representative, a new number will be assigned when the documents required by §601.502 are filed. The representative will then be notified of the assignment so that he or she can use the number on future correspondence with the Service.

In one situation, a number other than a unique, unrelated number will be used. Employee pension plan administrators are required to obtain an employer identification number in order to be recognized as the plan administrator, with all the rights and responsibilities of that position. For this reason, the employer identification number assigned to a plan administrator will be used on the CAF to identify that individual's plan administrator.

When the CAF is fully implemented, Service personnel will be able to determine quickly whether a taxpayer has authorized a representative to act on his or her behalf and, if so, the scope of the authority. The CAF will also make it possible to expedite mailings of refunds, notices, and other correspondence by automatically directing them to authorized representatives. In addition, the automated system will enable the Service to handle any other matters involving taxpayer representatives more efficiently and expeditiously and will reduce paperwork. For example, under the current manual system of maintaining representative information, it is often necessary to file several copies of authorizations at various Service offices during the course of routine proceedings. Implementation of the CAF will eliminate the need for many of these duplicative filings.

The proposed amendments to the

Statement of Procedural Rules are to be issued under the authority contained in 5 U.S.C. §§301 and 552.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably six copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

DRAFTING INFORMATION

The principal author of these proposed amendments is Carolyn Swift of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other Offices of the Internal Revenue Service participated in developing the amendments both on matters of substance and style.

Proposed Amendments to the Statement of Procedural Rules

The proposed amendments to the Statement of Procedural Rules (26 CFR Part 601) are as follows:

Paragraph (b) of §601.502 is amended by redesignating paragraphs (b)(2), (3), and (4) as (b)(3), (4), and (5), respectively and by adding a new paragraph (b)(2) to read as follows:

§601.502 Requirements for conference—recognition to practice and, in certain cases, power of attorney or tax information authorization.

* * * * *

(b) *Requirements to be met by taxpayer's representative in order to be recognized.* ***

(2) *Centralized Authorization File.* If a representative files with the Service the written declaration required under paragraph (b)(1) of this section and either a power of attorney or a tax information authorization (see paragraph (c) of this section), the representative will be assigned a unique individual number so that information regarding the authorization to represent a taxpayer can be reflected on the Service's Centralized Authorization File (CAF). In the case of an employee plan administrator who is required to obtain an employer identification number to be recognized as a plan administrator, the number used for the CAF will be the employer identification number assigned to the administrator. The CAF is an automated file, containing information regarding the authority of taxpayer representatives, that will allow the Service to handle matters regarding authorizations and representatives quickly and efficiently. Thus, for example, the CAF will allow Service personnel to identify representatives and the scope of their authority and will automatically direct copies of notices and correspondence to the person authorized by the taxpayer. After a representative has first been assigned a unique, individual number (or, in the case of an employee plan administrator,the employer identification number), he or she will be requested, but not required,to use that number on all correspondence with the Internal Revenue Service concerning any taxpayer he or she represents.

* * * * *

ROSCOE L. EGGER, JR.,
Commissioner of
Internal Revenue

(Filed by the Office of the Federal Register on March 30, 1982, 8:45 a.m., and published in the issue of the Federal Register for March 31, 1982, 47 F.R. 13533)

Notice of Proposed Rulemaking

Service of Notice of Levy by Mail

LR-160-81

SUMMARY: This document contains proposed regulations relating to the authority of the Service to serve notice of levy by mail. These regulations would provide the public with the guidance needed to comply with the law and would affect persons upon whom notices of levy are served.

DATES: Written comments and requests for a public hearing must be delivered or mailed by April 27, 1982. The amendments to §301.6331-1 are proposed to be effective for levies made after publication of final regulations in the Federal Register.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T, LR-160-81, Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Annie R. Alexander of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3287), not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the regulations under section 6331 of the Internal Revenue Code of 1954 (Code) relating to the authority of the Service to seize property by levy. Under section 6331 of the Code the term "levy" includes the power of distraint and seizure by any means. Regulation §301.6331-1(a)(1) provides that a levy may be made by serving a notice of levy on any person in possession of, or obligated with respect to, property or rights to property subject to levy.

In order to conserve resources, the Service has increased the number of notices of levy served by mail in accordance with law and longstanding administrative practice. Some persons upon whom notices of levy are served have expressed concern that the Service's longstanding practice has not been explicitly set forth in the regulations. Consequently, the Department of Treasury has decided to amend the regulations to specify the procedures to be followed by the Service in serving a notice of levy by mail. The amendment will also permit persons having more than one office within an Internal Revenue district to designate, with the consent of the district director, one office to which notices of levy are to be mailed.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably six copies) to the Commissioner of Internal Revenue. All comments will be available public inspection and copying. A lic hearing will be held upon writ- request to the Commissioner by person who has submitted written nments. If a public hearing is held, tice of the time and place will be blished in the Federal Register.

REGULATORY FLEXIBILITY STATEMENT

Although this document is a notice proposed rulemaking that solicits ublic comments, the Internal Rev- nue Service has concluded that the egulations proposed herein are inter- retative and that the notice and pub- c procedure requirements of 5 U.S.C. 53 do not apply. Accordingly, these roposed regulations do not constitute egulations subject to the Regulatory lexibility Act (5 U.S.C. chapter 6).

DRAFTING INFORMATION

The principal author of these proposed regulations is Annie R. Alexander of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Proposed amendments to the regulations

The proposed amendments to 26 CFR Part 301 are as follows:

Paragraph. A new paragraph (c) is added to §301.6331-1 to read as follows:

§301.6331-1 Levy and Distraint.

* * * * *

(c) *Service of notice of levy by mail.* A notice of levy may be served by mailing the notice to the person upon whom the service of a notice of levy is authorized under paragraph (a)(1) of this section. In such a case the date the notice is delivered to the person to be served is the date the levy is made. If the notice is sent by certified mail, return receipt requested, the date of delivery on the receipt is treated as the date the levy is made. If a person has more than one office within the Internal Revenue district, delivery to any one of the offices is sufficient. However, any person may, upon written application to the district director, request that any mailed notice of levy be sent to one designated office within the Internal Revenue district. If the district director concurs, notices of levy by mail must be sent to the designated office until the person and the district director agree that a different office should be designated.

ROSCOE L. EGGER, JR.,
Commissioner of
Internal Revenue.

(Filed by the Office of the Federal Register on February 25, 1982, 8:45 a.m., and published in the issue of the Federal Register for February 26, 1982, 47 F.R. 8378)

Notice of Proposed Rulemaking

Industrial Development Bonds for Residential Rental Housing

LR-161-81

SUMMARY: This document contains a proposed regulation under section 103(b) relating to industrial development bonds the proceeds of which are used for residential rental housing.

DATES: Written comments and requests for a public hearing must be delivered or mailed by July 26, 1982. In general, the regulations are proposed to be effective with respect to obligations issued after April 24, 1979.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-161-81), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Harold T. Flanagan of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention CC:LR:T, 202-566-3294).

SUPPLEMENTARY INFORMATION:

EXPLANATION OF PROVISIONS

This document contains proposed regulations relating to obligations issued under section 103(b)(4)(A) of the Internal Revenue Code of 1954, as amended by section 1103 of the Omnibus Reconciliation Act of 1980 (Pub. L. 96-449, [1980-2 C.B. 509, 517] 94 Stat. 2669).

Generally, interest on industrial development bonds is includible in the recipient's gross income. Section 103(b)(4)(A) provides an exception for obligations which are part of an issue substantially all the proceeds of which are to be used for a residential rental project. Subject to certain additional requirements, interest on such obligations is not includable in gross income.

Proposed §1.103-8(b)(4) would provide that a residential rental project is a building or structure or interrelated buildings or structures each containing more than one unit which are used on other than a transient basis and any facilities functionally related and subordinate to such units. Such units must be rented or available for rental on a continuous basis to members of the general public as generally required by §1.103-8(a)(2). Further, proposed §1.103-8(b)(5)(i) would require that, once available for occupancy, units in a project financed under this provision must be rented or available for rental on a continuous basis for a period equal to the greater of 20 years or the term of the obligation.

In addition, a specified percentage of the units in such project must be rented to individuals or families of low or moderate income. Under proposed §1.103-8(b)(1), 20 percent or more of the units would be required to be occupied by individuals or families of low or moderate income. However, a special rule would provide that for targeted area projects only 15 percent of such units are to be occupied by individuals or families of low or moderate income. Proposed §1.103-8(b)(6)(iii) would provide that a "targeted area project" is a project located in a qualified census tract or an area of chronic economic distress, as defined in §6a.103A-2(b)(4) and (5).

Proposed §1.103-8(b)(5)(ii) would provide that the 20 percent rule (or 15 percent rule for targeted area projects) must be met for the term of the obligation (including any refundings) but, in no instance, for less than 20 years. Under proposed §1.103-8(b)(5)(ii) a transitional rule would require that for obligations issued before January 1, 1984, such rule need only be met for 20 years, without regard to the term of the obligation.

The determination of whether an

individual or family is of low or moderate income would be made only at the time the tenancy commences. Thus, even if an occupant subsequently ceases to qualify, the unit would continue to be considered as occupied by an individual of low or moderate income during the tenancy. Further, the unit generally would continue to be treated as so occupied until a new occupant occupies the unit, at which time the character of the unit would be redetermined on the basis of whether the new occupant of the unit is of low or moderate income. It should be noted, however, that the status of a unit would be redetermined at the time that a new occupant commences residency, even though such occupant possesses no legal interest or right of occupancy in the unit.

Under proposed §1.103-8(b)(5)(iv) the involuntary loss or substantial destruction of a project would obviate the need to continue to comply with the occupancy and rental requirements if the obligation is retired within a reasonable period. This rule does not distinguish between losses which are compensated by insurance and those which are not.

Pursuant to §1.103-8(b)(5)(iii), noncompliance with the requirements of section 103(b)(4)(A) and §1.103-8(b) generally would result in the project not being treated as a project described in section 103(b)(4)(A). As such, if more than an insubstantial portion of the proceeds of an issue were used for such project, the interest on such obligations would not be excludable from gross income as of the date of issue. However, if the noncompliance results from events occurring after the issuance of the obligation and such non-compliance is corrected within a reasonable period then the tax-exempt status of the obligation would not be affected.

Further, under proposed §1.103-8(b)(2) obligations issued after December 31, 1981, must be issued "in registered form." This requirement also would apply to obligations issued to refund obligations issued to provide residential projects under section 103(b)(4)(A), without regard to the date of the prior issue. The term "in registered form" would have the same meaning as in §1.6049-2(d).

This notice also contains a proposed amendment to §1.103-10 which would deny the "small issue" exception provided by section 103(b)(6) to obligations issued for residential property for family units. In general, this rule would apply to any obligation if a significant portion of the proceeds thereof are used to provide financing for owner-occupied residences or residential rental property.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably six copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request made to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

REGULATORY FLEXIBILITY ACT

Although this notice of proposed rulemaking solicits public comment, the Internal Revenue Service has concluded that the regulations proposed are interpretative and thus not subject to the notice and public procedure requirements of 5 U.S.C. §553. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. Chapter 6).

NON-APPLICATION OF EXECUTIVE ORDER 12291

The Treasury Department has determined that this proposed regulation is not subject to review under Executive Order 12291 or the Treasury and OMB implementation of the Order dated April 28, 1982.

DRAFTING INFORMATION

The principal author of this proposed regulation is Harold T. Flanagan of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

* * * * *

Proposed amendment to the regulations

The proposed amendment to 26 CFR Part 1 is as follows:

Paragraph 1. Section 1.103-8 is amended by revising the second sentence of paragraph (a)(4), by revising paragraph (b), by deleting Examples (1) and (2) of paragraph (i) and redesignating Examples (3), (4), (5), (6), (7), and (8) thereof as Examples (1), (2), (3), (4), (5), and (6) respectively, and by amending redesignated Example (6) of paragraph (i). The revised and amended provisions read as follows:

§1.103-8 Interest on bonds to finance certain exempt facilities.

(a) *In general.*

* * * * *

(4) *Ultimate use of the proceeds.* *** For example, such proceeds will be treated as used to provide residential rental property whether the State or local governmental unit (i) constructs such property and leases or sells it to any person who is not an exempt person for use in such person's trade or business of leasing such property; (ii) lends the proceeds to any such person for such purpose; or (iii) lends the proceeds to banks or other financial institutions in order to increase the supply of funds for mortgage lending under conditions requiring such banks or other financial institutions to use such proceeds only for further lending for residential rental property.

* * * * *

(b) *Residential rental property—*(1) *General rule for obligations issued af ter April 24, 1979.* Section 103(b)(1 shall not apply to any obligation whic is issued after April 24, 1979, and i part of an issue substantially all of th proceeds of which are to be used t provide a residential rental project i which 20 percent or more of the uni are to be occupied by individuals families of low or moderate income (

defined in paragraph (b)(6)(v) of this section). In the case of a targeted area project, the minimum percentage of units which are to be occupied by individuals of low or moderate income is 15 percent. See generally §1.103-7(d) for rules relating to refunding issues.

(2) *Registration requirement.* Any obligation (including any refunding obligation) issued after December 31, 1981, to provide a residential rental project must be in registered form (as defined in paragraph (b)(6)(ii) of this section).

(3) *Transitional rule.* For purposes of this section, obligations issued after April 24, 1979, may be treated as issued before April 25, 1979, if the transitional requirements of section 1104 of the Mortgage Subsidy Bond Tax Act of 1980 [Pub. L. 96-499, 1980-2 C.B. 509, 517] (94 Stat. 2670) are satisfied.

(4) *Residential rental project.* (i) A residential rental project is a building or structure or several proximate and interrelated buildings or structures—

(*a*) Each containing more than one unit (as defined in paragraph (b)(6)(i) of this section) which are to be used on other than a transient basis and any facilities which are functionally related and subordinate to such units, and

(*b*) All of the units of which are rented or available for rental on a continuous basis to members of the general public in accordance with the requirement of paragraph (a)(2).

Substantially all of the project must consist of similar units together with any functionally related and subordinate facilities. Under paragraph (a)(3) of this section, facilities that are functionally related and subordinate to residential rental projects include facilities for use by the tenants, for example, swimming pools, parking areas, and recreational facilities. Hotels, motels, dormitories, fraternity and sorority houses, rooming houses, hospitals, sanitariums, rest homes, and trailer parks and courts for use on a transient basis are not residential rental projects.

(ii) For purposes of this paragraph (b), interrelated buildings or structures are part of the same project only if owned for federal tax purposes by the same person.

(iii) In no event shall proceeds provided to a cooperative housing corporation (as defined in section 216(b)(1)) be considered to provide a residential rental project.

(5) *Requirements must be continuously satisfied—*

(i) *Rental requirement.* Once available for occupancy, each unit (as defined in paragraph (b)(6)(i) of this section) in a residential rental project must be rented or available for rental on a continuous basis during the period described in subdivision (ii)(*a*) of this paragraph (b)(5). Such requirement is not satisfied with respect to any unit occupied by the owner of such project or an individual related to the owner. An individual is related to the owner of such project if the owner is:

(*a*) A member of the individual's family as defined in section 267(c)(4);

(*b*) A corporation more than 1 percent in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;

(*c*) A partnership more than 1 percent in value of the capital interest or the profits interest of which is owned, directly or indirectly, by or for such individual; or

(*d*) A trust more than 1 percent in value of the corpus or the income of which is owned, directly or indirectly, by or for such individual.

For purposes of subdivision (*i*), the principles under section 267(c) apply to determine the constructive ownership of stock in a corporation, an interest in a partnership or the corpus or income of a trust.

(ii) *Low or moderate income occupancy requirement.* (*a*) Except as provided in paragraph (b)(5)(ii)(*b*) of this section, the occupancy requirement for individuals of low or moderate income (and the rental requirement of this paragraph (b)(5)) must be satisfied on a continuous basis, commencing on the later of the date that the project is available for occupancy, or the date of issuance of the obligations, and terminating on the later of twenty years after the commencement date, or the retirement of the obligations (including any refundings).

(*b*) With respect to obligations issued before January 1, 1984, which do not meet the

graph (b)(3) of this section, including obligations which refund such obligations, the period for continuing compliance with the requirement of this subdivision (ii) shall be 20 years commencing from the date determined in the same manner as set forth in paragraph (b)(5)(ii)(*a*) of this section.

(*c*) A unit occupied by an individual or family who at the commencement of the occupancy are of low or moderate income shall be treated as occupied by such an individual or family during such individual's or family's tenancy in such unit, even though the individual or family subsequently ceases to have a low or moderate income. Moreover, a unit shall be treated as occupied by an individual or family of low or moderate income until occupied, other than for a temporary period, by another occupant, at which time the character of the unit shall be redetermined. In no event shall a temporary period exceed 31 days.

(iii) *Effect of non-compliance.* Non-compliance with the requirements of this paragraph shall cause the project to be treated as other than a project described in section 103(b)(4)(A) and this paragraph (b) as of the date of issue. After an issue to provide such a project ceases to qualify, subsequent conformity with the requirements will not alter the taxable status of such obligations. However, if an issuer corrects any non-compliance arising from events occurring after the issuance of the obligation, (*e.g.*, an unauthorized sub-lease) within a reasonable period, the tax-exempt status of the issuance will not be altered. A reasonable period shall not be less than 60 days after such error is first discovered or should have been discovered.

(iv) *Involuntary and unforeseen loss.* Subdivision (iii) of this paragraph (b)(5) shall not apply in the event of non-compliance caused by an involuntary loss or the substantial destruction of a project as a result of unforeseen events (*e.g.*, fire, seizure, requisition, foreclosure or condemnation), even though compensated by insurance, provided the obligations used to provide such project are retired within a reasonable period. If the obligations are not retired, subdivision (iii) shall not apply provided any amounts received as a consequence of such loss or destruction also are used to provide a project which meets the requirements of section 103(b)(4)(A) and this paragraph (b).

(6) *Definitions*. For purposes of this paragraph—

(i) *Unit*. The term "unit" means any separate accommodation containing complete facilities for living, sleeping, eating, cooking, and sanitation. Such accommodations may be served by centrally located equipment such as air conditioning or heating. Thus, for example, an apartment containing a living area, a sleeping area, bathing and sanitation facilities, and cooking facilities equipped with a cooking range, refrigerator, and sink, all of which are separate and distinct from other apartments, would constitute a unit.

(ii) *In registered form*. The term "in registered form" has the same meaning as in §1.6049-2(d). Thus, in general, an obligation is issued in registered form if it is registered as to both principal and interest and if its transfer must be effected by the surrender of the old instrument to the issuer and by either the reissuance of the old instrument to a new holder or the issuance of a new instrument to a new holder.

(iii) *Targeted area project*. The term "targeted area project" means a project located in a qualified census tract (as defined in §6a.103A-2(b)(4)) or an area of chronic economic distress (as defined in §6a.103A-2(b)(5)).

(iv) *Building and structure*. The terms "building" and "structure" generally mean an edifice or other manmade construction consisting of interrelated parts (*e.g.*, foundations, walls, or roofs) and constituting property which is or would, if such property were placed in service after 1980, be entitled to a separate election under section 168(b)(3)(B)(ii). Thus, if two units located on a single tract or parcel (or contiguous tracts or parcels) of land are not contained within one edifice consisting of interrelated parts, then they are separate buildings or structures for purposes of this paragraph.

(v) *Low or moderate income*. The term "low or moderate income" has the same meaning as in §1.167(k)-3(b). The method of determining low or moderate income in effect at the time that the obligation is issued will be determinative for such issue, even if such method is subsequently changed.

(7) *Examples*. The following examples illustrate the application of this paragraph (b).

Example (1). In 1982, City A issues $10 million of registered bonds with a term of 20 years to be used to finance the construction of an apartment building to be available to members of the general public. A leases the project to Corporation X for 20 years. The lease requires annual payments sufficient to amortize the principal and interest on the bonds. Corporation X has an option to purchase the facility at the end of the 20 year period. X is the owner of the project for federal income tax purposes. The lease payments and the property secure payment of principal and interest on the bonds. Corporation X maintains 20 percent of the units in the project for low or moderate income individuals and meets all of the requirements of this section until 2002, at which time X purchases the project from A and converts the project to offices. The bonds are industrial development bonds, but because the proceeds are used for construction of residential rental property, which is an exempt facility under section 103(b)(4)(A) and paragraph (b) of this section, section 103(b)(1) does not apply.

Example (2). The facts are the same as in example (1), except that the facility is constructed adjacent to a factory, and factory employees are to be given preference to its employees in selecting tenants. The bonds are industrial development bonds and the facility is not an exempt facility under section 103(b)(4)(A) and paragraph (b) of this section because it is not a facility constructed for use by the general public.

Example (3). The facts are the same as in example (1), except that the proceeds of the obligation are provided to Y, a cooperative housing corporation, to finance the construction of a cooperative housing project. Y sells stock in such cooperative to individual tenant-shareholders who either occupy such units or rent such units. Such project is not a residential rental project within the meaning of section 103(b)(4)(A) and §1.103-8(b)(4). Further, the bonds are mortgage subsidy bonds under section 103A because the proceeds are indirectly used to provide financing for residences, some of which are owner-occupied and some of which are used in the trade or business of rental.

Example (4). On February 1, 1984, County Z issues registered obligations with a term of 40 years to provide funds to construct a garden apartment project. The project is not a targeted area project. As a condition for providing such financing Z requires that a covenant be contained in the deed for the project which restricts occupancy of 20 percent of the units to individuals or families of low or moderate income. Further, the deed states, "Such covenant shall run with and bind the land, for a term of forty (40) years from the date that the project is first available for occupancy. The right to enforce the aforementioned restriction for the benefit of the low or moderate income citizens of County Z is vested in County Z." In 1990, however, less than 20 percent of the units are occupied by families or individuals of low or moderate income and County Z fails to enforce the covenant within a reasonable time. Since 20 percent of such units are not maintained for individuals and families of low or moderate income for 40 years, such project will not be residential rental property within the meaning of section 103(b)(4)(A) and section (b)(1) from February 1, 1984.

Example (5). On January 15, 1983, State X issues registered obligations the proceeds of which are loaned to Corporation Z in order that Corporation Z can construct an apartment building. The project will be a "targeted area project" within the meaning of §1.103-8(b)(6)(iii). Corporation Z intends to maintain 15 percent of the units in the project for individuals having low or moderate income for 20 years. Further Corporation Z converts 80 percent of the units to condominiums in 1988. Corporation Z repays the loan to State X which, in turn, redeems the obligations. The obligations are not used to provide a residential rental project within the meaning of section 103(b)(4)(A) but are indirectly used to construct condominiums which are owner-occupied residences described in section 103A.

Example (6). In 1982, State Y issues 40 year bonds the proceeds of which will be used to acquire and restore an apartment building located in a targeted area. Y leases the project to Corporation Z for 40 years. Z will rent as residences all the units in the restored apartment building. Corporation Z further contracts with Public Housing Agency W for W to subsidize the rents of low and moderate income tenants residing in the building for 20 years. Throughout 1987, Z, however, fails to maintain at least 15 percent of the units in such project for individuals and families of low or moderate income. Since 15 percent of the units are not rented to individual of low or moderate income for 20 years, such project will not be residential rental property within the meaning of section 103(b)(4)(A) and §1.103-8(b)(4).

Example (7). On January 15, 1984, State Z issues obligations with a term of 5 years the proceeds of which will be used to provide a residential apartment building. Z sells the project to Corporation U and receives a 30 year mortgage. The mortgage requires that U maintain at least 20 percent of the units for occupancy by individuals of low or moderate income for the term of the mortgage. The mortgage may not be prepaid in whole or in part without the express permission of Z. On January 15, 1988, Z issues 35 year refunding bonds the proceeds of which are used to retire the obligations issued in 1984. In order to meet the requirements of §1.103-8(b)(5)(ii), 20 percent of such units must be occupied by individuals of low or moderate income for 39 years.

Example (8). The facts are the same as in example (7) except that the mortgage permits the mortgagor to prepay the mortgage in the event of loss by fire or flood. In 1987, the apartment building is substantially destroyed by fire. The building was insured at its fair market value. U does not intend to reconstruct the building but uses a portion of the insurance proceeds to repay the unpaid balance of the mortgage, which Z uses to redeem the outstanding bonds at the first available call date. Since the project was substantially destroyed by an unforeseen event and the outstanding bonds are retired at the first available call date, the property does not need to continue to meet the requirements of section 103(b)(4)(A) or this paragraph (b).

Example (9). The facts are the same as in example (7) except that in 1987 U defaults on the mortgage and Z forecloses on the project. Z sells the project to Y and uses the proceeds to retire the outstanding bonds within a reasonable period. Y is not required to meet the requirements of section 103(b)(4)(A) and this paragraph since Y did not obtain the project with obligations described in section 103(b)(4)(A).

Obligations issued before April
79—(i) *General rules.* Section
(1) shall not apply to obligations
before April 25, 1979, which
rt of an issue substantially all of
oceeds of which are to be used to
e residential real property for
units. In order to qualify under
ragraph (b)(8) as an exempt fa-
the facility must satisfy the pub-
e requirement of paragraph
of this section by being available
e by members of the general
.

Family units defined. For pur-
of this paragraph (b)(6) the term
y unit" means a building or any
n thereof which contains com-
living facilities which are to be
n other than a transient basis by
r more persons, and facilities
onally related and subordinate
o. Thus, an apartment which is
used on other than a transient
as a residence by a single person
a family which contains com-
facilities for living, sleeping, eat-
cooking, and sanitation, consti-
a family unit. Such a unit may be
l by centrally located machinery
quipment as in a typical apart-
building. To qualify as a family
the living facilities must be a sep-
self-contained building or con-
e one unit in a building substan-
all of which consists of similar
together with functionally re-
and subordinate facilities and
Hotels, motels, dormitories, fra-
y and sorority houses, rooming
s, hospitals, sanitariums, rest
s, and trailer parks and courts
e on a transient basis do not con-
e residential real property for
y units.

) *Functionally related and subor-*
e facilities. Under paragraph
of this section, facilities which
unctionally related and subordi-
to residential real property ac-
used for family units include,
xample, facilities for use by the
pants such as a swimming pool, a
ng area, and recreational facili-

* * * * *

*amples.****

mple (6). City G issues $20 million of its
and will use $6 million to finance residential rental property which qualifies as an exempt facility under section 103(b)(4)(A) and paragraph (b) of this section, $9 million to finance construction of a stadium which qualifies as an exempt facility under section 103(b)(4)(B) and paragraph (c) of this section, and $5 million for convention facilities which qualify as exempt facilities under section 103(b)(4)(C) and paragraph (d) of this section. The facilities will be used in the trades or businesses of nonexempt persons and rental payments with respect to such facilities and the facilities themselves will be the security for the bonds. The bonds are industrial development bonds, but since all the proceeds are to be used for facilities which are exempt facilities under section 103(b)(4), section 103(b)(1) does not apply unless the provisions of section 103(b)(10) and §1.103-11 apply. The result would be the same, if, instead of using $9 million to finance construction of a stadium, the $9 million were used to finance construction of a capitol building. [Reg. §1.103-8].

* * * * *

Par. 2. Section 1.103-10 is amended by redesignating paragraph (f) as paragraph (g) and by adding a new paragraph (f) immediately after paragraph (e). New paragraph (f) reads as follows;

§1.103-10 Exemption for certain small issues of industrial development bonds.

* * * * *

(f) *Disqualification of certain small issues.* (1) Section 103(b)(6) shall not apply to any obligation issued after April 24, 1979, which is part of an issue a significant portion of the proceeds of which are to be used directly or indirectly to provide residential real property for family units. Thus, for example, an issue of obligations issued to provide financing for owner-occupied residences or residential rental property is not an exempt small issue for purposes of this section.

(2) For purposes of subparagraph (1), a significant portion of the proceeds of an issue are used to provide residential real property for family units if 5 percent or more of the proceeds are so used.

* * * * *

ROSCOE L. EGGER, JR.,
Commissioner of
Internal Revenue.

(Filed by the Office of the Federal Register on May 24, 1982, 8:45 a.m., and published in the issue of the Federal Register for May 26, 1982, 47 F.R. 22966)

Notice of Proposed Rulemaking

Collection of Past-Due Support from Federal Tax Refunds

LR-189-81

SUMMARY: In T.D. 7808, page 204, this Bulletin, the Internal Revenue Service is issuing temporary regulations on procedure and administration relating to the collection of past-due support from Federal tax refunds. The text of those temporary regulations also serves as the comment document for this proposed rulemaking.

DATES: Written comments and requests for a public hearing must be delivered or mailed by April 9, 1982. The amendments are proposed to be effective as final regulations on March 10, 1982.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T (LR-189-81).

FOR FURTHER INFORMATION CONTACT: Susan K. Thompson of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W. 20224 (Attention: CC:LR:T) (202-566-3294).

SUPPLEMENTARY INFORMATION:

EXPLANATION

The temporary regulations in the Rules and Regulations portion of this issue of the Federal Register add a new Part 304 to Title 26 of the Code of Federal Regulations. The final regulations, which this document proposes to be based on the text of those temporary regulations, would be added to Part 301 of Title 26 of the Code of Federal Regulations as final regulations under section 6402 of the Internal Revenue Code of 1954. The temporary regulations implement section 6402(c) of the Internal Revenue Code of 1954 which provides for the collection of past-due support by offset against Federal tax refunds. For the text of the temporary regulations, see FR Doc. [T.D. 7808 page 204, this Bulletin] published in the Rules and Regulations portion of this issue of the

FEDERAL REGISTER. The preamble to the temporary regulations explains their provisions.

These regulations are proposed to be issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (26 U.S.C. 7805; 68A Stat. 917) and section 2331(a) of the Omnibus Budget Reconciliation Act of 1981 (Pub. L. 97-35, [1981-2 C.B. 528] 95 Stat. 357) amending section 464(a) of the Social Security Act (88 Stat. 2351).

REGULATORY FLEXIBILITY ACT

Pursuant to 5 U.S.C. 605(b), the Secretary of the Treasury has certified that the requirements of the Regulatory Flexibility Act do not apply to this Notice of Proposed Rulemaking as it will not have a significant economic impact on a substantial number of small entities. The regulations impose recordkeeping duties only upon State agencies responsible for child and spousal support enforcement.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before the adoption of these proposed regulations, consideration will be given to any written comments that are submitted (preferably six copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the Federal Register.

DRAFTING INFORMATION

The principal author of these regulations is Susan K. Thompson of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, on matters of both substance and style.

JOSEPH T. DAVIS,
Acting Commissioner
of Internal Revenue.

(Filed by the Office of the Federal Register on February 3, 1982, 5:03 p.m., and published in the issue of the Federal Register for February 8, 1982, 47 F.R. 5728).

Notice of Proposed Rulemaking

Tax-Exempt Financing for Qualified Mass Commuting Vehicles

LR-192-81

SUMMARY: This document contains proposed regulations relating to the issuance of tax-exempt bonds for the acquisition of qualified mass commuting vehicles. Changes to the tax law were made by the Economic Recovery Tax Act of 1981 [Pub. L. 94-34, 1981-2 C.B. 256]. The regulations would provide guidance to issuers and holders of obligations used for the acquisition of such vehicles.

DATES: Written comments and requests for a public hearing must be delivered or mailed by March 1, 1982. The amendments are proposed to be effective with respect to obligations issued after August 13, 1981, and before January 1, 1985.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, 1111 Constitution Avenue, N.W., Attention: CC:LR:T, Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Susan K. Thompson of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3294).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 103(b)(4)(I) and (9) of the Internal Revenue Code of 1954. These amendments are proposed to conform the regulations to section 811 of the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256, 349] (95 Stat. 349) and are to be issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

EXPLANATION OF NEW PROVISIONS

Under section 103, interest on State and local government obligations is generally exempt from Federal income tax. However, tax exemption is denied to State and local government issues of industrial development bonds with certain exceptions. Certain industrial development bonds qualify for the exemption where the proceeds of the bonds are used to provide exempt facilities. Included among these facilities are mass commuting facilities, but not, under prior law, the vehicles used for mass commuting purposes.

The Economic Recovery Tax Act of 1981 provides that interest on obligations or a State of local government are exempt from Federal income tax if substantially all of the proceeds of the obligations are used to provide qualified mass commuting vehicles. This term is defined to mean a bus, subway car, rail car, or similar equipment leased to a mass transit system that is wholly owned by one or more governmental units and that is used by the mass transit system in providing mass commuting services.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before the adoption of these proposed regulations, consideration will be given to any written comments that are submitted (preferably six copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

REGULATORY FLEXIBILITY ACT

Although this is a notice of proposed rulemaking which solicits public comment, the Internal Revenue Service has concluded that the regulations oposed are interpretative and that e notice and public procedure re- uirements of U.S.C. §553 do not ap- y. Accordingly, these proposed nendments do not constitute regula- ons subject to the Regulatory Flexi- ility Act (5 U.S.C. Chapter 6).

DRAFTING INFORMATION

The principal author of these pro- osed regulations is Susan K. Thomp- on of the Legislation and Regulations ivision of the Office of Chief Coun- el, Internal Revenue Service. How- ver, personnel from other offices of he Internal Revenue Service and reasury Department participated in eveloping the regulations, on matters f both substance and style.

roposed amendments to the regula- ions

The proposed amendments to 26 FR Part 1 are as follows:

Section 1.103-8 is amended by rede- ignating paragraph (i) as paragraph k) and by adding new paragraphs (i) nd (j) immediately following para- raph (h). These added paragraphs ead as follows:

§1.103-8 Interest on bonds to finance certain exempt facilities.

* * * * *

(i) *Qualified hydroelectric generating facilities.* [Reserved.]

(j) *Qualified mass commuting vehicles*—(1) *General rule.* Section 103(b)(4)(I) provides that section 103(b)(1) shall not apply to obligations issued by a State or local governmental unit which are part of an issue substantially all the proceeds of which are to be used to provide qualified mass commuting vehicles. The term "qualified mass commuting vehicle" is defined in section 103(b)(9) and paragraph (j)(2) of this section. Section 103(b)(4)(I) and (9) and this paragraph (j) apply only to obligations issued after August 13, 1981, and before January 1, 1985.

(2) *Qualified mass commuting vehicle defined.* For purposes of section 103(b)(4)(I) and (9) and this paragraph, the term "qualified mass commuting vehicle" means any bus, subway car, rail car or similar equipment—

(i) That is leased to a mass transit system wholly owned by one or more governmental units, or agencies or instrumentalities of a governmental unit, and

(ii) That is used by the mass transit system in providing mass commuting services.

(3) *Similar equipment.* For purposes of paragraph (j)(2), the term "similar equipment" means a vehicle for the transportation of passengers. Thus, for example, the term "similar equipment" includes a street car, cable car, van, hydroplane, or ferry vessel. It also includes a vehicle used to power a vehicle that transports passengers, such as the engine car of a subway train. The term "similar equipment" does not include machinery, furniture, or other equipment or parts not attached to, located in, or otherwise made an integral part of a vehicle. Machinery, furniture, or other non-vehicular equipment not made a part of a vehicle as described in the preceding sentence may qualify as a part of, or as functionally related and subordinate to, a mass commuting facility under section 103(b)(4)(D) and §1.103-8(a)(3). For other rules relating to mass commuting facilities, see §1.103-8(e)(2)(iv).

(4) *Mass commuting services.* A transportation service is a mass commuting service within the meaning of section 103(b)(9) and this paragraph (j) if it is used predominantly by business commuters on a day-to-day basis. Thus, for example, a sightseeing service is not a mass commuting service because it is not used predominantly by business commuters. Likewise, the transportation of children to and from school is not a mass commuting service.

(5) [illegible]*lic use requirement.* To qualify [illegible]der section 103(b)(4) and paragra[illegible](a)(2) of this section as a mass co[illegible]uting vehicle, the vehicle must ser[illegible]r be available on a regular basis for [illegible]eral public use. A vehicle will not [illegible]alify under this section if more than an insubstantial portion of its use is [illegible]eserved for the exclusive benefit of particular individuals or private groups. For example, a van used by employees of a specific employer or employers will not qualify as a mass commuting vehicle.

(6) *Wholly owned by governmental unit.* Section 103(b)(9) and paragraph (j)(2) of this section require that a qualified mass commuting vehicle be leased to a mass transit system wholly owned by one or more governmental units (or agencies or instrumentalities of a governmental unit). In determining whether an entity qualifies as a governmental unit or agency or instrumentality of a governmental unit, the rules of section 103(a)(1) and §1.103-1 apply.

* * * * *

ROSCOE L. EGGER, JR.,
Commissioner of
Internal Revenue.

Approved December 28, 1981.

JOHN E. CHAPOTON,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on December 28, 1981, 5:03 p.m., and published in the issue of the Federal Register for December 31, 1981, 46 F.R. 63326)

Notice of Proposed Rulemaking

Certain Amounts Refunded in Reinsurance Transactions

LR-276-81

SUMMARY: This document contains proposed regulations relating to the treatment of certain amounts refunded in reinsurance transactions and the allocation of certain items in modified coinsurance transactions. The proposed regulations affect all life insurance company taxpayers that engage in reinsurance transactions in which certain amounts are refunded, or that enter into modified coinsurance contracts to which the rules of section 820 apply, and provide them with the guidance to comply with the law.

DATES: Written comments and requests for a public hearing must be delivered or mailed by May 18, 1982. Except as otherwise provided, the proposed regulations are proposed to be effective for certain amounts refunded after March 18, 1982.

ADDRESS: Send comments and a request for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-276-81), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Alice M. Bennett of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3238).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under sections 809, 811 and 820 of the Internal Revenue Code of 1954. The proposed regulations provide rules clarifying the treatment by life insurance companies of certain amounts refunded in reinsurance transactions. The proposed regulations also clarify the circumstances under which a proper consent may be made to the application of section 820 to modified coinsurance contracts by providing rules with respect to the allocation of certain items in the contract.

The proposed regulations are to be issued under the authority contained in sections 820(c) and 7805 of the Internal Revenue Code of 1954 (73 Stat. 112; 68A Stat. 917; 26 U.S.C. 820(c) and 7805).

AMOUNTS REFUNDED IN REINSURANCE TRANSACTIONS

The proposed regulations clarify the treatment of amounts refunded in reinsurance transactions where the amount of the refund depends on the experience of the reinsurer with respect to the policies reinsured. These amounts refunded, often referred to as experience refunds or experience rated refunds, are treated under present regulations as a return premium of the reinsurer and, with respect to modified coinsurance, as premium income of the reinsured. This treatment under present regulations, however, does not reflect the fact that all or part of the refund may reflect a return of investment income rather than premium income.

Accordingly, effective for amounts refunded or credited for refund after March 18, 1982, the proposed regulations provide that the portion of the refund allocable to investment income derived from the assets relating to the reserves on the policies reinsured is to be treated as investment income of the reinsured and as a corresponding reduction in investment income of the reinsurer. The refund is considered allocable to investment income to the extent of the gross investment income derived from the assets relating to the reserves on the policies reinsured less the sum of the required interest computed with respect to those reserves and the investment expenses of the reinsurer attributable to such gross investment income. The excess, if any, of the amount of the refund over the portion allocable to investment income is treated as premium income of the reinsured and as a return premium of the reinsurer. The rules apply to refunds generated by coinsurance and modified coinsurance contracts.

ALLOCATION RULES FOR MODIFIED COINSURANCE CONTRACTS

The proposed regulations also contain rules to clarify the circumstances under which consent may be made to the application of section 820 to modified coinsurance contracts. Effective for contracts entered into or modified after March 18, 1982, and for other contracts to the extent of any policies reinsured after March 18, 1982, the proposed regulations provide that there must be a proportional allocation between the reinsurer and the reinsured of the premiums, gross investment income, capital gains and losses, reserve, assets and expenses relating to the reinsured policies in order to consent to the application of section 820 to the contract. The proposed regulations, however, do not create any inference as to what rule will apply before the effective date of these regulations with respect to allocations of such items in modified coinsurance contracts.

REGULATORY FLEXIBILITY ACT

Although this document is a notice of proposed rulemaking that solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

COMMENTS AND REQUEST FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably six copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

DRAFTING INFORMATION

The principal author of this regulation is Alice M. Bennett of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Proposed amendments to the regulations

The proposed amendments to 26 CFR Part 1 are as follows:

INCOME TAX REGULATIONS
(26 CFR Part 1)

Paragraph 1. Paragraph (a) of §1.809-4 is amended by revising paragraph (a)(1)(ii), redesignating paragraph (a)(1)(iii) as paragraph (a)(1)(iv), and by adding new paragraph (a)(1)(iii) to read as follows:

§1.809-4 Gross amount.

(a) *Items taken into account.*

* * * * *

([illegible]) Premiums—(i)***

(ii) The term "return premiums" means amounts returned or credited which are fixed by contract and do not depend on the experience of the company or the discretion of the management. Thus, such term includes amounts refunded due to policy cancellations or erroneously computed premiums. Furthermore, amounts of premiums or other consideration returned to another life insurance company in respect of reinsurance ceded shall be included in return premiums. In the case of an amount refunded or credited for refund by the reinsurer to the reinsured after March 18, 1982, where the amount of the refund depends on the experience of the reinsurer with respect to the policies reinsured, the term "amounts of premiums and other consideration returned to another life insurance company in respect of reinsurance ceded" includes only that portion of such refund which exceeds the allocable investment income of the reinsurer. For purposes of the preceding sentence, the term "allocable investment income of the reinsurer" means the gross investment income of the reinsurer derived from the assets held with respect to the reserve on the policy reinsured less the sum of the required interest (as defined in section 809(a)(2)) with respect to such reserve and the investment expenses (as defined in section 804(c)(1)) of the reinsurer attributable to such gross investment income. To the extent of the allocable investment income of the reinsurer, the amount refunded or credited for refund shall be treated as a reduction in gross investment income of the reinsurer under section 804(b)(1) and as gross investment income received by the reinsured under section 804(b)(1). The gross investment income so treated shall be considered as derived proportionately from each of the various sources of gross investment income of the reinsurer allocable to the assets in relation to the reserve on the policy reinsured. For the treatment of other amounts which do not meet the requirements of return premiums, see section 811 (relating to dividends to policyholders).

(iii) The provisions of paragraph (a)(1)(ii) of this section may be illustrated by the following examples:

Example (1). R, a life insurance company, reinsures a block of its pre-existing policies with S, a life insurance company, under a coinsurance agreement entered into on January 1, 1979. Under the agreement, R will pay to S the premium income received on the policies reinsured and will transfer to S assets equal in value to the reserves established with respect to the policies reinsured. S will pay to R an amount equal to all death benefits and certain expenses relating to the policies reinsured. S will pay all other expenses relating to the policies reinsured. In addition, S agrees to refund to R an amount which depends on the experience of S with respect to the policies reinsured. Under the agreement, this refund will be computed by subtracting the death benefits, expenses and other deductions (including any increases in reserves) relating to the policies reinsured, along with the fee charged by S for reinsuring the policies, from the premium income, investment income and any other items of income (including any decreases in reserves) relating to the policies reinsured. During 1982, R pays to S premium income of $100x on the policies reinsured. S receives gross investment income of $80x on the assets held with respect to the reserves on the policies reinsured. S pays to R an amount equal to death benefits of $25x and expenses of $5x on the reinsured policies. S incurs expenses and other deductions relating to the policies of $63x (which includes an increase in reserves of $40x and investment expenses of $10x), and charges a fee of $2x. On December 31, 1982, the amount credited for refund by S to R as computed under the agreement is $85x. Assume that the required interest with respect to the reserves on the policies reinsured is $33x. The amount credited for refund of $85x shall be treated by R and S in the following manner for the taxable year ending December 31, 1982: Since the amount of the allocable investment income of S is $37x ($80x - ($33x + 10x)), R will increase its gross investment income by $37x and S will reduce its gross investment income by $37x. The amount of $48x, which is the excess of the amount credited for refund over the allocable investment income ($85x - $37x), is treated as premium income of R and a return premium of S.

Example (2). Assume the same facts as in example (1) except that the contract is a modified coinsurance contract for which the parties have consented to the application of section 820. The amount credited for refund of $85x shall be treated in the same manner as in example (1). Therefore, R will include $37x as gross investment income received and $48x as premium income. S will reduce its gross investment income by $37x and will treat $48x as a return premium.

For purposes of section 809(c)(1) and this subparagraph, the term "reinsurance ceded" means an arrangement whereby the taxpayer (the reinsured) remains solely liable to the policyholder, whether all or only a portion of the risk has been transferred to the reinsurer. Such term includes indemnity reinsurance transactions but does not include assumption reinsurance transactions. See paragraph (a)(7)(ii) of §1.809-5 for the definition of assumption reinsurance.

*   *   *   *   *

Par. 1a. Paragraph (a) of §1.809-5 is amended by revising paragraph (a)(7) to read as follows:

§1.809-5 Deductions.

(a) *Deductions allowed.*

*   *   *   *   *

(7) *Assumption by another person of liabilities under insurance, etc., contracts.* (i) The consideration (other than consideration arising out of reinsurance ceded as defined in paragraph (a)(1)(iv) of §1.809-4) in respect of the assumption by another person of liabilities under insurance and annuity contracts (including contracts supplementary thereto) of the taxpayer.

(ii) For purposes of section 809(d)(7) and this subparagraph, the term "assumption reinsurance" means an arrangement whereby another person (the reinsurer) becomes solely liable to the policyholders on the contracts transferred by the taxpayer. Such term does not include indemnity reinsurance or reinsurance ceded (as defined in paragraph (a)(1)(iv) of §1.809-4).

*   *   *   *   *

Par. 2. Paragraph (a) of §1.811-2 is amended to read as follows:

§1.811-2 Dividends to policyholders.

(a) *Dividends to policyholders defined*. Section 811(a) defines the term "dividends to policyholders", for purposes of part I, subchapter L, chapter 1 of the Code, to mean dividends and similar distributions to policyholders in their capacity as such. The term includes amounts returned to policyholders where the amount is not fixed in the contract but depends on the experience of the company or the discretion of the management. In general, any payment not fixed in the contract which is made with respect to a participating contract (that is, a contract which during the taxable year contains a right to participate in the divisible surplus of the company) shall be treated as a dividend to policyholders. Similarly, any amount refunded or allowed as a rate credit with respect to either a participating or a nonparticipating contract shall be treated as a dividend to policyholders if such amount depends on the experience of the company. However, the term does not include interest paid (as defined in section 805(e) and paragraph (b) of §1.805-8) or return premiums (as defined in section 809(c) and paragraph (a)(1)(ii) of §1.809-4). Thus, so-called excess-interest dividends and amounts returned by one life insurance company to another in respect of reinsurance ceded shall not be treated as dividends to policyholders even though such amounts are not fixed in the contract but depend upon the experience of the company or the discretion of the management.

Furthermore, any portion of an

amount refunded or credited for refund by the reinsurer to the reinsured after March 18, 1982, which depends on the experience of the reinsurer in respect of reinsurance ceded and which does not constitute an amount of premium or other consideration returned to another life insurance company in respect of reinsurance ceded, as defined in paragraph (a)(1)(ii) of §1.809-4, shall be treated in the manner prescribed in paragraph (a)(1)(ii) of §1.809-4 and not as a dividend to policyholders.

* * * * *

Par. 3. Paragraph (a) of §1.820-3 is amended by revising paragraph (a)(1) and by adding new paragraph (a)(9) to read as follows:

§1.820-3 Special rules.

(a) *In general.****

(1)(i) Premiums (to the extent allocable to the participation of the reinsurer therein) received for the policy reinsured shall be treated as received by the reinsurer and not by the reinsured. Amounts returned by the reinsurer to the reinsured shall be treated as reductions in premium income of the reinsurer under section 809(c)(1) and as other amounts received by the reinsured under section 809(c)(1).

(ii) In the case of an amount refunded or credited for refund by the reinsurer to the reinsured after March 18, 1982, where the amount of the refund depends on the experience of the reinsurer with respect to the policies reinsured (often referred to as an experience refund or experience rated refund), the term "amounts returned by the reinsurer to the reinsured" referred to in paragraph (a)(1)(i) of this section includes only that portion of such refund which exceeds the allocable investment income of the reinsurer. For purposes of the preceding sentence, the term "allocable investment income of the reinsurer" means the gross investment income allocated under paragraph (a)(2)(i) of this section to the reinsurer with respect to the policy reinsured less the sum of the required interest (as defined in section 809(a)(2)) with respect to the reserve on the policy reinsured and the investment expenses (as defined in section 804(c)(1)) attributable to such gross investment income and allocated to the reinsurer under paragraph (a)(6)(ii) of this section. To the extent of the allocable investment income of the reinsurer, the amount refunded or credited for refund shall be treated as a reduction in gross investment income of the reinsurer under section 804(b)(1) and as gross investment income received by the reinsured under section 804(b)(1). The gross investment income so treated shall be considered as derived proportionately from each of the various sources of gross investment income of the reinsured in the manner prescribed in paragraph (a)(2)(i) of this section.

* * * * *

(9)(i) With respect to modified coinsurance contracts entered into or modified after March 18, 1982, and to other modified coinsurance contracts to the extent of any policies reinsured after March 18, 1982, the items described in paragraphs (a)(1) through (a)(6) of this section shall be allocated proportionately between the reinsured and the reinsurer.

(ii) The provisions of paragraph (a)(9)(i) of this section may be illustrated by the following examples:

Example (1). R, a life insurance company enters into a modified coinsurance contract with S, a life insurance company on December 31, 1981. Under the terms of the contract, R will cede 90 percent of the risk on a block of its preexisting policies to S as of the effective date of the contract. Under the contract, R also agrees to reinsure with S on December 31, 1982, 90 percent of the risk on any policies issued by R during 1982. The contract provides for an allocation to S of 80 percent of the premiums, gross investment income, capital gains and losses, reserve, assets and expenses relating to the policies reinsured. Dividends are to be allocated under a reimbursement agreement between R and S. The allocations under the contract have been satisfied the proportional allocations requirement of paragraph (a)(9)(i) of this section with respect to the policies reinsured after March 18, 1982.

Example (2). Assume the same facts as in example (1) except that under the contract, only 60 percent of the premiums relating to the policies reinsured are allocated to S. The allocations under the contract have not satisfied the proportional allocations requirement of paragraph (a)(9)(i) of this section with respect to the policies reinsured after March 18, 1982. Thus, R and S have not consented to the special rules of section 820(c) with respect to those policies that were reinsured on December 31, 1982.

* * * * *

ROSCOE L. EGGER, JR.,
Commissioner of
Internal Revenue.

(Filed by the Office of the Federal Register on March 16, 1982, 12:28 p.m., and published in the issue of the Federal Register for March 19, 1982, 47 F.R. 11882)

Notice of Proposed Rulemaking

Penalties for Underpayment of Deposits and Overstated Deposit Claims

LR-311-81

SUMMARY: This document contains proposed regulations relating to the penalty for underpayment of deposits and the penalty for overstated deposit claims. The penalty for overstated deposit claims was added by the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256]. The regulations would provide guidance to officers and employees of the Internal Revenue Service with respect to the application of these civil penalties. The regulations would also provide guidance to the public in obtaining relief from the penalty for overstated deposit claims if the overstatement was due to reasonable cause. The regulations would also remove outdated regulation provisions relating to the penalty for underpayment of deposits. The regulations would affect all taxpayers required to make deposits of any internal revenue tax with government depositaries.

DATES: Written comments and requests for a public hearing must be delivered or mailed by July 20, 1982. These regulations are proposed to be effective with respect to returns filed after August 13, 1981.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-311-81), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Martha E. Kadue of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3238, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Regulations on Procedure and Administration (26 CFR Part 301) under section 6656 of the Internal Revenue Code of 1954, as amended by section 724 of the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256, 346] (95 Stat. 344). These amendments are proposed to be issued under the authority contained in section 7805 (68A Stat. 917, 26 U.S.C. §7805) of the Internal Revenue Code of 1954.

DISCUSSION

Section 6656(a) of the Code imposes a penalty of 5 percent of the amount of any underpayment of a mandatory deposit. This penalty is imposed if a taxpayer fails to make a required deposit or makes a deposit of an amount less than the amount required to be deposited. Current regulations relating to this penalty contain rules for deposits required to be made before January 1, 1970, based on the law in effect for those deposits. The proposed regulations would delete these outdated provisions.

Section 6656(b) was amended by section 724 of the Economic Recovery Tax Act of 1981. The amendment provides a new penalty for overstated deposit claims made in returns filed after August 13, 1981. Overstated deposit claims are amounts claimed in a return to have been deposited in a government depositary that have not actually been deposited. The penalty of 25 percent of the overstated deposit claim is imposed unless the taxpayer shows that the overstated claim was due to reasonable cause and was not due to willful neglect. The penalty applies in addition to any other penalties, such as the penalty provided by section 6656(a), relating to underpayments of deposits.

The proposed regulations define an overstated deposit claim as the excess of the amount of deposits claimed on a return over the amounts actually deposited in a government depositary on or before the date the return is filed. An overstated deposit claim includes a claim of deposits when no deposits have been made as well as a claim of an amount of deposits in excess of the amount actually deposited. The proposed regulations also set forth the procedure (which is the same procedure as is available with respect to the penalty imposed by section 6656(a)) by which a taxpayer can assert that the overstated deposit claim was due to reasonable cause and was not due to willful neglect.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably six copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

REGULATORY FLEXIBILITY ACT AND EXECUTIVE ORDER 12291

The Commissioner of Internal Revenue has determined that this proposed rule is not subject to Executive Order 12291. Although this document is a notice of proposed rulemaking which solicits public comment, the Internal Revenue Service has concluded that the proposed regulations are interpretative and that the notice and public comment procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

DRAFTING INFORMATION

The principal author of these proposed regulations is Martha E. Kadue of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing these regulations, both on matters of substance and style.

* * * * *

Proposed amendments to the regulations.

The proposed amendments to 26 CFR Part 301 are as follows:

Paragraph 1. Section 301.6656-1 is revised to read as follows:

§301.6656-1 Penalty for underpayment of deposits.

(a) *General rule.* If any person is required by the Code or regulations prescribed thereunder to deposit any tax in a government depositary that is authorized under section 6302(c) to receive the deposit, and fails to deposit the tax within the time prescribed therefore, a penalty shall be imposed on such person unless the failure is shown to be due to reasonable cause and not due to willful neglect. The penalty shall be 5 percent of the amount of the underpayment without regard to the period during which the underpayment continues. For purposes of this section, the term "underpayment" means the amount of tax required to be deposited less the amount, if any, that was deposited on or before the date prescribed therefor.

(b) *Assertion of reasonable cause.* To show that the underpayment was due to reasonable cause and not willful neglect, a taxpayer must make an affirmative showing of all facts alleged as a reasonable cause in a written statement containing a declaration that it is made under the penalties of perjury. The statement must be filed with the district director for the district or the director of the service center where the return with respect to the tax is required to be filed. If the district director or the director of the service center determines that the underpayment was due to reasonable cause and was not due to willful neglect, the penalty will not be imposed.

Par. 2. A new §301.6656-2 is added immediately after §301.6656-1, to read as follows:

§301.6656-2 Penalty for overstated deposit claims.

(a) *General rule.* Any person who makes an overstated deposit claim on a return is subject to a penalty equal to

25 percent of such claim, unless it is shown that the overstated deposit claim is due to reasonable cause and not willful neglect. This penalty is in addition to any other penalty provided by law, such as the penalty provided by section 6656(a), relating to underpayment of deposits.

(b) *Overstated deposit claim*. An overstated deposit claim is the excess of—

(1) The amount of any internal revenue tax that a person claims, in a return filed after August 13, 1981, to have deposited for any period in a government depositary authorized under section 6302(c) to receive the deposit, over

(2) The aggregate amount for that period the person has deposited on or before the date the return for that period is filed, in a government depositary authorized under section 6302(c) to receive the deposit.

An overstated deposit claim includes a claim that deposits have been made when no deposits have been made in an authorized government depositary. For purposes of this paragraph (b), the date a return is considered to be filed is the later of the date the return is due to be filed (not including extensions) or the date the return is actually filed. The application of this paragraph is illustrated by the following examples.

Example 1. On the date a return is due for the taxable period ended December 31, 1982, Z files the return claiming deposits of tax in the amount of $150 for that period. Z actually made deposits of $75 for that period on or before the date the return was due and filed. Z's tax liability for that period is $150. Z has made an overstated deposit claim in the amount of $75, the excess of the amount of tax claimed on the return to have been deposited ($150), over the amount actually deposited ($75) for that period on or before the date the return was due and filed.

Example 2. On the date a return is due for the quarter ended December 31, 1982, X files the return claiming deposits of tax in the amount of $200 for that period. X actually made deposits of $100 for that period on or before the date the return was due and filed. X's tax liability for that period is $100. X has made an overstated deposit claim of $100, the excess of the amount of tax claimed on the return to have been deposited ($200), over the amount actually deposited ($100) for that period on or before the date the return was due and filed.

Example 3. The facts are the same as in example 2. For the quarter ended March 31, 1983, X files a return on the date it is due, claiming $100 (the excess of the amount of tax claimed to have been deposited on the prior quarter's return, $200, over X's liability for the prior quarter, $100) as a deposit for the quarter ended March 31, 1983. X did not actually deposit any amount for the quarter ended March 31, 1983, on or before the date the return was due and filed. X made an overstated deposit claim of $100 for the quarter ended December 31, 1982, as described in example 2. For the quarter ended March 31, 1983, X made an overstated deposit claim of $100, the excess of the amount of tax claimed to have been deposited ($100), over the amount actually deposited (0) for that period on or before the date the return was due and filed.

(c) *Assertion of reasonable cause*. To show that an overstated deposit claim was due to reasonable cause and not willful neglect, a taxpayer must make an affirmative showing of all facts alleged as a reasonable cause in a written statement containing a declaration that it is made under the penalties of perjury. The statement must be filed with the district director for the district or the director of the service center where the return with respect to the tax is required to be filed. If the district director or the director of the service center determines that the overstated deposit claim was due to reasonable cause and was not due to willful neglect, the penalty will not be imposed.

ROSCOE L. EGGER, JR.
Commissioner of
Internal Revenue.

(Filed by the Office of the Federal Register on May 25, 1982, 8:45 a.m., and published in the issue of the Federal Register for May 26, 1982, 47 F.R. 22970)

Notice of Proposed Rulemaking

Exempt Royalty Oil

LR-313-81

ACTION: Amendment of proposed rulemaking by cross-reference to amended temporary regulations.

SUMMARY: In the Rules and Regulations portion of [the] Federal Register, the Internal Revenue Service is issuing temporary excise tax regulations relating to exempt royalty oil [T.D. 7811, page 186, this Bulletin]. The Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256] added exempt royalty oil to the class of oils which are exempt from the crude oil windfall profit tax. The exemption applies to oil removed after December 31, 1981. The text of those temporary regulations also serves as the comment document for this proposed rulemaking.

DATES: Written comments and requests for a public hearing must be delivered or mailed by May 3, 1982.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-313-81), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: David R. Haglund of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3459).

SUPPLEMENTARY INFORMATION:

The temporary regulations in the Rules and Regulations portion of the Federal Register amend 26 CFR Part 150. The final regulations, which are proposed to be based on the temporary regulations, would amend 26 CFR Part 51. For the text of the temporary regulations, see FR Doc. (T.D. 7811) published [page 186, this Bulletin]. The preamble to the temporary regulations explains the addition to the regulations.

These regulations are proposed to be issued under the authority contained in sections 4995 and 7805 of the Internal Revenue Code (95 Stat. 337 and 68A Stat. 917; and 26 U.S.C. 4995 and 7805).

REGULATORY FLEXIBILITY ACT

Pursuant to 5 U.S.C. 605(b), the Secretary of the Treasury has certified that the requirements of the Regulatory Flexibility Act do not apply to this notice of proposed rulemaking as it will not have a significant economic impact on a substantial number of small entities. The regulations affect primarily individual royalty owners and do not significantly alter the recordkeeping duties of small entities. The exemption certificate procedure is beneficial to qualified royalty owners since they do not have to wait until the end of the year to receive a refund. Purchasers are relieved of withholding the Windfall Profit Tax where a certificate is furnished to them by a qualified royalty owner.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably six copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

ROSCOE L. EGGER, JR.,
Commissioner of
Internal Revenue.

(Filed by the Office of the Federal Register on February 26, 1982, 2:41 p.m., and published in the issue of the Federal Register for March 3, 1982, 47 F.R. 9018)

Notice of Proposed Rulemaking

Travel Expenses of Members of Congress

LR-4-82

SUMMARY: The Internal Revenue Service is issuing amendments to temporary income tax regulations that relate to Travel Expenses of Members of Congress [T.D. 7802, page 53, this Bulletin]. The text of those amendments also serves as the comment document for this proposed rulemaking.

DATES: Written comments and requests for a public hearing must be delivered or mailed by March 22, 1982. The regulations are proposed to be effective for taxable years beginning after December 31, 1980.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-4-82), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Jason R. Felton of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3318).

SUPPLEMENTARY INFORMATION:

BACKGROUND

The temporary regulations*** amend the Temporary Regulations under Title 5e Travel Expenses of Members of Congress. The final regulations, which this document proposes to be based on those amendments to the temporary regulations, would be added to Part 1 of Title 26 of the Code of Federal Regulations. For the text of the amendments to the temporary regulations, see [T.D. 7802, page 53, this Bulletin]. The preamble to the temporary regulations explains the amendments to the regulations.

The temporary regulations provide rules under section 274 to allow deductions for traveling expenses for Members of Congress that may be claimed without substantiation.

These regulations are proposed to be issued under the authority contained in section 280A(f)(4)(B) and 7805 of the Internal Revenue Code (26 U.S.C. 7805; 26 U.S.C. 280A(f)(4)(B) 95 Stat. 1641, 68A Stat. 917).

REGULATORY FLEXIBILITY ACT

Although this document is a notice of proposed rulemaking which solicits pubic comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before the adoption of these proposed regulations, consideration will be given to any written comments that are submitted (preferably six copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

ROSCOE L. EGGER, JR.,
Commissioner of
Internal Revenue.

(Filed by the Office of the Federal Register on January 15, 1982, 10:48 a.m., and published in the issue of the Federal Register for January 21, 1982, 47 F.R. 3006)

Announcement of the Disbarment, Suspension, Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice Before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Bernard J. Riley	Greenwood Lake, NY	Certified Public Accountant	Indefinite effective December 8, 1981
Vernon J. Collins	Cherokee, OK	Attorney	Five months effective December 28, 1981
Nicholas J. Lomangino	Brooklyn, NY	Attorney	Indefinite effective December 30, 1981
John Guardado	San Pedro, CA	Certified Public Accountant	Indefinite effective January 5, 1982
Richard D. Crittenden	Southfield, MI	Certified Public Accountant	Indefinite effective January 18, 1982
Robert H. Gullett	Southfield, MI	Enrolled Agent	Indefinite effective February 3, 1982
Nicholas B. Stallworth	Mobile, AL	Enrolled Agent	Indefinite effective March 1, 1982
Raymond E. Culver, Jr.	Kingston Springs, TN	Certified Public Accountant	Indefinite effective March 1, 1982

Name	Address	Designation	Term of Suspension
Clara M. Judisch	Sarasota, FL	Attorney	March 1, 1982 through June 30, 1982
ohn C. Welden	Grants Pass, OR	Certified Public Accountant	Indefinite effective March 30, 1982
Ronald N. Fern	North Miami, FL	Certified Public Accountant	Indefinite effective April 12, 1982
Elwood Munson	Austin, TX	Certified Public Accountant & Attorney	Indefinite effective April 22, 1982
Ira A. Deutsch	New York, NY	Attorney	Indefinite effective May 6, 1982
Edwin N. Popkin	Bristol, PA	Attorney	Indefinite effective May 21, 1982

Under Section 1026, Title 31 of the United States Code (1970 ed.), the ecretary of the Treasury, after due otice and opportunity for hearing, is uthorized to suspend or disbar from practice before the Internal Revenue ervice any person who has violated he rules and regulations governing he recognition of attorneys, certified public accountants, enrolled agents or enrolled actuaries to practice before he Internal Revenue Service.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been disbarred or suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date of disbarment or period of suspension. This announcement will appear and will continue to appear in the weekly Bulletins for five successive weeks for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

After due notice and hearing before the Administrative Law Judge, the following individuals have been suspended from further practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Lewis P. Terrell	Lubbock, TX	Attorney	Ninety days effective January 18, 1982
Norma J. Mathews	Granada Hills, CA	Enrolled Agent	Six months effective January 15, 1982

By decision on appeal from an initial decision in an administrative hearing, the following individual has been disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Jack M. Hill	San Jose, CA	Enrolled Agent	February 3, 1982

After due notice and opportunity for hearing the following individuals have been disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
William B. McCallum	Minneapolis, MN	Attorney	March 11, 1982
Barry I. Robinson	San Diego, CA	Attorney	March 22, 1982
Frank C. Dunbar, Jr.	Columbus, OH	Attorney	March 19, 1982
John L. Vanker	Grosse Point Shores, MI	Attorney	February 18, 1982

Announcement of the Resignation of Enrolled Agents from Practice Before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an enrolled agent, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his resignation. The Director of Practice, in his discretion, may accept the offered resignation of an enrolled agent.

To enable the public and other practitioners to identify such resigned enrolled agents, the Director of Practice will announce in the Internal Revenue Bulletin the name and address of each enrolled agent who has so resigned and the date of resignation. This announcement will appear in the weekly Bulletin at the earliest practicable date after the action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each resigned enrolled agent, and will later be consolidated and published in the Cumulative Bulletin.

The following individual has resigned from enrollment to practice before the Internal Revenue Service:

Name of Enrolled Agent	Address	Effective Date of Resignation
Laurin R. Redfearn, Jr.	Cheraw, SC	February 22, 1982

Announcement of the Resignation from Enrollment to Perform Actuarial Services Under the Employee Retirement Income Security Act of 1974

Under 20 Code of Federal Regulations, Part 901, an enrolled actuary, in order to avoid the initiation or conclusion of a suspension or termination proceeding, may offer his/her resignation. The Executive Director, Joint Board for the Enrollment of Actuaries, may accept the resignation in accordance with the consent offered.

To enable employees of the Internal Revenue Service and others to identify such persons, the Executive Director will announce in the Internal Revenue Bulletin the name and address of each enrolled actuary who has entered a resignation as provided for by 20 CFR 901.34(b). This announcement will appear in the weekly Bulletin at the earliest practicable date following resignation, will continue to appear in the weekly Bulletin for at least three successive weeks, and will later be consolidated and published in the Cumulative Bulletin.

A resignation from enrollment to perform actuarial services under the Employee Retirement Income Security Act of 1974 has been entered for the following person:

Name	Address	Effective Date
Michael F. McCoy	Indianapolis, IN	April 1, 1982

Index

The abbreviation and number in parentheses following the index entry refer to the specific item; numbers following the parentheses refer to the page number on which it appears.

Key to Abbreviations:

RR	Revenue Ruling
RP	Revenue Procedure
TD	Treasury Decision
CD	Court Decision
PL	Public Law
EO	Executive Order
DO	Delegation Order
TDO	Treasury Department Order
TC	Tax Convention
SPR	Statement of Procedural Rules
PTE	Prohibited Transaction Exemption

EMPLOYMENT TAX

Administration:
Delegation of authority:
Closing agreements (DO 97 (Rev. 19)) 33[illegible]
Consents fixing period of limitations (DO 42 (Rev. 15)) 334; (DO 42 (Rev. 16)) 334
Deficiency notices (DO 77 (Rev. 15)) 335
Furnishing special statistical studies (DO 100 (Rev. 3)) 338
Levy on property in hands of third parties (DO 191) 352
Notice of additional inspection of books (DO 57 (Rev. 5)) 335
Reorganization of the Service (DO 156 (Rev. 2)) 343; (DO 156 (Rev. 2), Amend. 1) 349
Rulings, revocation of determination letters, retroactively (DO 96 (Rev. 6)) 336

EMPLOYMENT TAXES—Continued

Administration: —Continued
Delegation of authority—Continued
Seizure and forfeiture of personal property (DO 157 (Rev. 3)) 350
Settlement recommendation letters, Department of Justice (DO 155 (Rev. 1)) 342
Termination and jeopardy assessments (DO 160 (Rev. 3)) 350
Transfer of Technical and Appeals functions to Chief Counsel (DO 190) 350
Internal Revenue Districts, Foreign Operations, created (TDO 150-96) 511
Procedural rules, proposed, 26 CFR 601.502, implementation of file for authorized taxpayer representatives (LR-120-81) 559
Reorganization, Internal Revenue Service National Office, functions, Chief Counsel (TDO 150-95) 510
U.S. Court of Appeals for the Federal Circuit and U.S. Claims Court, establishment (PL 97-164) 316
Assessment (See: Limitation period)
Closing agreements:
Rulings procedure (RP 37) 491; (RP 38) 503
Compensation (See: Railroad retirement; Unemployment funds)
Contributions to States:
Unemployment funds:
New Hampshire (RP 34) 489
Delegation of authority (See: Administration)
Employer-employee:
Corporate officers (RR 83) 151
Forms:
Computer-prepared and computer-generated (RP 4) 380
Reproduction:
1087 and 1099 series and W-2G (RP 5) 406
W-2, W-2P, and W-3 (RP 12) 429
Reproduction requirements (RP 3) 368
SS-10, limitation period, assessment, parent and subsidiaries (RP 6) 409

EMPLOYMENT TAXES—Continued

International organizations:
Multinational Force and Observers and International Food Policy Research Institute (EO 12359) 352
Liability for tax:
Employee:
Illegal aliens (RR 116) 152
Treatment, corporate officers (RR 83) 151
FICA, Amish employer (CD 2011) 148
Sick pay (RP 20) 466
Limitation period:
Assessments, parent and subsidiaries, Form SS-10 (RP 6) 409
Period of limitation (See: Limitation period)
Proposed regulations:
26 CFR 31.3401(a)-1, 31.3402(a)-1, 31.3402(b)-1, 31.3402(c)-1, 31.6001-5, amended; withholding, accident or health plans (LR-74-77) 520
26 CFR 301.6106(j)(1)-1(b)(2)(i)—301.6103(j)(1)-1(b)(3), 301.6103(j)(1)-1(b)(5)(ii), 301.6103(j)(1)-1(c), 301.6103(p)(2)(B)-1, amended; disclosures of return information to the Department of Commerce (LR-111-81) 557
26 CFR 301.6331-1, amended; service of notice of levy by mail (LR-160-81) 560
26 CFR 301.6652-1, revised; 301.6652-2, added; penalty, underpayment of deposits, overstated deposit claims (LR-311-81) 570
Railroad retirement:
Employer:
Beginning of tax liability (RR 100) 155
Cessation of tax liability (RR 99) 154
Docking facility operated for carrier (RR 64) 154
Rate determination, quarterly 153
Sick pay (RP 20) 466

EMPLOYMENT TAXES—Continued

- Receipts:
  - Withholding from sick pay (TD 7813) 160
- Refunds and credits:
  - Withholding, new Form W-4 information, repayment or reimbursement (RR 84) 208
- Regulations:
  - 26 CFR 31.3401(e)-1(b), 31.3402(f)(2)-1, 31.3402(n)-1, amended; 37.3402-1, deleted; submission of withholding exemption certificates, Forms W-4 (TD 7803) 155
  - 26 CFR 31.3402(o)-1, amended; 32.1 redesignated 31.3402(o)-2 and as redesignated amended; Part 32 deleted; voluntary withholding, annuity payments (TD 7804) 159
  - 26 CFR 31.3402(o)-3, 31.6051-3, added; 35.1 (Sec. 3402), 35.2 (Sec. 6051), deleted; voluntary withholding from sick pay (TD 7813) 160
- Reproduction of forms and returns (See: Forms)
- Returns (See also: Forms):
  - Facsimile signatures (RR 29) 200
- Rulings:
  - Issuance procedures (RP 37) 491
  - Technical advice to District Directors, issuance procedure (RP 38) 503
- Self-employment tax:
  - Community property states (RR 39) 119
- Statute of limitations (See: Limitation period)
- Unemployment funds:
  - Certification of state, New Hampshire (Notice 12) 359
  - Contributions:
    - Credit reduction, 1981 (RP 1) 366
    - New Hampshire (RP 34) 489
- Wages:
  - Sick pay (RP 20) 466
  - Sick pay, coverage (PL 97-123) 314
  - Withholding, submission of exemption certificates, Forms W-4 (TD 7803) 155

EMPLOYMENT TAXES—Continued

- Withholding:
  - Employee:
    - Illegal aliens (RR 116) 152
    - Treatment, corporate officers (RR 83) 151
  - Liability to withhold, Amish employer (CD 2011) 148
  - New Form W-4 information, repayment or reimbursement (RR 84) 208
  - Sick pay, voluntary (TD 7813) 160
  - Submission of exemption certificates, Forms W-4 (TD 7803) 155
  - Supplemental wage payment (RR 46) 158
  - Voluntary, annuity payments (TD 7804) 159

ESTATE & GIFT TAXES

Administrative

- Administration:
  - Closing agreements, rulings procedure (RP 38) 503
  - Delegation of authority:
    - Closing agreements (DO 97 (Rev. 19)) 337
    - Consents fixing period of limitations (DO 42 (Rev. 15)) 334; (DO 42 (Rev. 16)) 334
    - Decision on reports of refunds and credits to Joint Committee (DO 154 (Rev. 1)) 342
    - Deficiency notices (DO 77 (Rev. 15)) 335
    - Extension of time, estate tax returns (DO 116 (Rev. 5)) 341
    - Furnishing special statistical studies (DO 100 (Rev. 3)) 338
    - Levy on property in hands of third parties (DO 191) 352
    - Notice of additional inspection of books (DO 57 (Rev. 5)) 335
    - Reorganization of the Service (DO 156 (Rev. 2)) 343; (DO 156 (Rev. 2), Amend. 1) 349
    - Rulings, revocation of determination letters, retroactively (DO 96 (Rev. 6)) 336

ESTATE & GIFT TAXES—Continued

Administrative—Continued

- Administration—Continued
  - Delegation of authority—Continued
    - Seizure and forfeiture of personal property (DO 157 (Rev. 3)), 350
    - Settlement recommendation letters, Department of Justice (DO 155 (Rev. 1)) 342
    - Signing of agreements regarding charitable deductions (DO 136 (Rev. 4)) 341
    - Tax treaties, competent or taxation authority (DO 114 (Rev. 3)) 341
    - Termination and jeopardy assessments (DO 160 (Rev. 3)) 350
    - Transfer certificates (DO 144 (Rev. 1)) 342
    - Transfer of Technical and Appeals functions to Chief Counsel (DO 190) 350
  - Internal Revenue Districts, Foreign Operations, created (TDO 150-96) 511
  - Procedural rules, proposed, 26 CFR 601.502, implementation of file for authorized taxpayer representatives (LR-120-81) 559
  - Reorganization, Internal Revenue Service National Office, functions, Chief Counsel (TDO 150-95) 510
  - Rulings, technical advice to District Director, issuance procedure (RP 38) 503
  - U.S. Court of Appeals for the Federal Circuit and U.S. Claims Court, establishment (PL 97-164) 316
- Credits (See: Refunds and credits)
- Delegation of authority (See: Administration)
- Elections:
  - Valuation, farms and closely held businesses, special use value, retroactive (RR 62) 130
- Extension of time:
  - Estate tax:
    - Installment method, annual interest payments, closely held business (RR 120) 203
    - Payment, closely held business, residuary charitable bequest (RR 6) 137

ESTATE & GIFT TAXES—Continued

Administrative—Continued

- Forms:
  - Reproduction requirements (RP 3) 368
- Liens:
  - Farms, special use value, state death tax credit (RR 35) 128
- Payment of tax:
  - Installment method:
    - Annual interest payments, closely held business (RR 120) 203
    - Closely held business, residuary charitable bequest (RR 6) 137
- Proposed regulations:
  - 26 CFR 301.6106(j)(1)-1(b)(2)(i)—301.6103(j)(1)-1(b)(3), 301.6103(j)(1)-1(b)(5)(ii), 301.6103(j)(1)-1(c), 301.6103(p)(2)(B)-1, amended; disclosures of return information to the Department of Commerce (LR-111-81) 557
  - 26 CFR 301.6331-1, amended; service of notice of levy by mail (LR-160-81) 560
  - 26 CFR 301.6652-1, revised; 301.6652-2, added; penalty, underpayment of deposits, overstated deposit claims (LR-311-81) 570
- Refunds and credits:
  - Estate tax, state death tax credit, farms, special use (RR 35) 128
  - Special use valuation under ERTA (RP 9) 413
- Reproduction of forms and returns (See: Forms)
- Returns (See: Forms)
- Rulings:
  - Areas in which advance rulings will not be issued (RP 22) 469
  - Areas in which rulings will not be issued, charitable lead interest qualifying as a guaranteed annuity interest (RP 11) 429
  - Issuance procedures (RP 37) 491
  - Obsolete (RR 127) 215

Estate Tax

- Administration (See: ADMINISTRATION)

ESTATE & GIFT TAXES—Continued

Estate Tax—Continued

- Alternate valuation (See: Valuation)
- Business interest (See: Valuation)
- Charitable, etc., transfers:
  - Bequests, residue, value, closely held business (RR 6) 137
  - Trust remainder, death of income beneficiary, judicial reformation (RR 97) 138
- Claims against estate:
  - Deduction for claims against the estate, Canada (RR 82) 127
- Closing agreements (See: ADMINISTRATIVE)
- Credits against tax:
  - Foreign death taxes, Canada (RR 82) 127
  - State death tax credit, farms, special use value, liens (RR 35) 128
- Damages:
  - Survivor's loss benefits, no-fault automobile insurance (RR 5) 131
- Deductions (See specific subject headings)
- Delegation of authority (See ADMINISTRATIVE: Administration)
- Elections (See: ADMINISTRATIVE)
- Extension of time (See: ADMINISTRATIVE)
- Foreign taxes (See: Credits against tax)
- Generation-skipping transfers (See: Transfers)
- Gross estate (See also specific subject headings):
  - Insurance proceeds, corporation as beneficiary, stock redemption (RR 85) 137
- Husband and wife (See: Marital deduction)
- Insurance (See: Life insurance)
- Interests in property (See also: Valuation):
  - Prior transfers, trusts, contingent remainder interest (RR 24) 134
  - Survivor's loss benefits, no-fault automobile insurance (RR 5) 131

ESTATE & GIFT TAXES—Continued

Estate Tax—Continued

- Life insurance:
  - Corporation as beneficiary, stock redemption (RR 85) 137
  - Survivor's loss benefits, no-fault automobile insurance (RR 5) 131
  - Transfer within 3 years of death, group term (RR 13) 132
- Marital deduction:
  - "Estate equalization clause," alternate valuation date (RR 23) 139
- Payment of tax (See: ADMINISTRATIVE)
- Powers of appointment:
  - General, no ascertainable standard (RR 63) 135
- Proposed regulations (See also: ADMINISTRATIVE):
  - 26 CFR 20.6324B-1, added; 301.6325-1, amended; special lien for additional estate tax attributable to farm, etc., special use valuaiton (LR-201-76) 519
- Regulations:
  - 26 CFR 26.2601-1, revised; generation-skipping transfers, effective date (TD 7812) 147
- Remainder interests (See: Interests in property; Transfers)
- Rulings (See: ADMINISTRATIVE)
- Tax:
  - Credit (See: Credits against tax)
  - Deductions:
    - Foreign death taxes, Canada (RR 82) 127
  - Payments (See: ADMINISTRATIVE: Payment of tax)
- Transfers:
  - Charitable remainder annuity trust, private annuitant, valuation (RR 105) 133
  - Generation-skipping:
    - Addition to trust, valuation date (RR 36) 146
    - Effective date (TD 7812) 147
  - Life insurance, within 3 years of death, group term (RR 13) 132
  - Trust, prior transfer of contingent remainder interest (RR 24) 134

ESTATE & GIFT TAXES—Continued

Estate Tax—Continued

- Trust:
  - Charitable remainder:
    - Death of income beneficiary, judicial reformation (RR 97) 138
    - Private annuitant, valuation (RR 105) 133
  - Generation-skipping, addition to trust, valuation date (RR 36) 146
  - Powers of appointment, ascertainable standard (RR 63) 135
- Valuation:
  - Alternate:
    - Marital deduction, "estate equalization clause" (RR 23) 139
  - Farms and closely held businesses:
    - Elections, credit or refund (RP 9) 413
    - Farms, special use value, interest rates (RR 104) 129
    - Special use value:
      - Liens (RR 35) 128
      - Retroactive election (RR 62) 130
  - General:
    - Stock redemption, wholly owned corporation, insurance proceeds (RR 85) 137
    - Trust, prior transfer of contingent remainder interest (RR 24) 134

Gift Tax

- Administration (See: ADMINISTRATIVE)
- Closing agreements (See: ADMINISTRATIVE)
- Delegation of authority (See: ADMINISTRATIVE: Administration)
- Disclaimer (See: Property: Interests)
- Exclusions:
  - Medical expenses paid on behalf of another (RR 98) 141
- Gifts:
  - *Medical expenses* paid on behalf of another (RR 98) 141
  - Transfers of contingent remainder interest (CD 2012) 142

ESTATE & GIFT TAXES—Continued
Gift Tax—Continued

- Property:
  - Interests, trust, transfer, contingent remainder interest (CD 2012) 142
- Proposed regulations (See: ADMINISTRATIVE)
- Remainder interests (See: Property: Interests; Trust)
- Rulings (See: ADMINISTRATIVE)
- Transfers:
  - Medical expenses paid on behalf of another (RR 98) 141
  - Trust, contingent remainder interest (CD 2012) 142
- Trusts:
  - Transfer of contingent remainder interest (CD 2012) 142

EXCISE TAXES

- Administration:
  - Delegation of authority:
    - Average weight agreements, tires and tubes (DO 130 (Rev. 2)) 341
    - Closing agreements (DO 97 (Rev. 19)) 337
    - Consents fixing period of limitations (DO 42 (Rev. 15)) 334; (DO 42 (Rev. 16)) 334
    - Deficiency notices (DO 77 (Rev. 15)) 335
    - Determination letters, exempt organizations (DO 113 (Rev. 7)) 340
    - Extension of correction period allowable distribution period, private foundations and employee plans (DO 139 (Rev. 6)) 342
    - Furnishing special statistical studies (DO 100 (Rev. 3)) 388
    - Levy on property in hands of third parties (DO 191) 352
    - Notice of additional inspection of books (DO 57 (Rev. 5)) 335
    - Reorganization of the Service (DO 156 (Rev. 2)) 343; (DO 156 (Rev. 2), Amend 1) 349

EXCISE TAXES—Continued

- Administration:—Continued
  - Delegation of authority—Continued
    - Rulings, revocation of determination letters, retroactively (DO 96 (Rev. 6)) 336
    - Seizure and forfeiture of personal property (DO 157 (Rev. 3)) 350
    - Settlement recommendation letters, Department of Justice (DO 155 (Rev. 1)) 342
    - Termination and jeopardy assessments (DO 160 (Rev. 3)) 350
    - Transfer of Technical and Appeals functions to Chief Counsel (DO 190) 350
  - Internal Revenue Districts, Foreign Operations, created (TDO 150-96) 511
  - Procedural rules, proposed, 26 CFR 601.502, implementation of file for authorized taxpayer representatives (LR-120-81) 559
  - Reorganization, Internal Revenue Service National Office, functions, Chief Counsel (TDO 150-95) 510
  - U.S. Court of Appeals for the Federal Circuit and U.S. Claims Court, establishment (PL 97-164) 316
- Assessments (See: Limitation period)
- Automobiles and trucks (See: Manufacturers)
- Closing agreements:
  - Ruling procedures (RP 37) 491; (RP 38) 503
- Coal (See: Manufacturers)
- Communications:
  - Articles purchased by parent-teachers association, donated to state school (RR 31) 166
  - Community action organization, state or local government exemption (RR 30) 165
- Credits (See: Refunds and credits)
- Crude oil windfall profit tax (See: Windfall profit tax)
- Delegation of authority (See: Administration)
- Exemption (See specific subject headings)

Forms:
  - 872-B, limitation period, assessment, parent and subsidiaries (RP 6) 409
  - Magnetic tape, windfall profit tax (RP 10) 414
  - Reproduction requirements (RP 3) 368

Gasoline (See: Manufacturers)

Highway use tax (See: Use tax)

Liability for tax:
  - Importer, fishing equipment, sales price (RR 40) 175

Limitation period:
  - Assessments, parents and subsidiaries, Form 872-B (RP 6) 409

Lubricating oil (See: Manufacturers)

Manufacturers:
  - Automotive, etc.:
    - Chassis and bodies:
      - Truck, exclusion, railroad track guide wheels (RR 52) 168
      - Truck, sale after exempt lease (RR 7) 167
    - Parts or accessories:
      - Further manufacture, credits and refunds (RR 14) 210
      - Light duty truck, simultaneous retail purchase of part or accessory (RR 19) 169
      - Railroad track guide wheels for highway vehicles (RR 52) 168
    - Coal:
      - Temporary increase in tax, black lung benefit trusts (PL 97-119) 7, *15*
  - Exemption:
    - Articles purchased by parent-teachers association, donated to state school (RR 31) 166
    - Community action organization (RR 30) 165
      - Exported articles, trucks, leased in foreign country, later sold in U.S. (RR 7) 167
    - International organizations, Multinational Force and Observers and International Food Policy Research Institute (EO 12359) 352

Manufacturers: —Continued
  - Exemption —Continued
    - Lubricating oil, qualified business use, highway vehicle (RR 77) 211
    - Tax-free sales, part or accessory sold for installation on light duty truck (RR 19) 169
  - Gasoline:
    - Refunds and credits, resale by wholesale distributor (RR 53) 210
  - Lubricating oil:
    - Refunds and credits, qualified business use, highway vehicle (RR 77) 211
  - Sales price:
    - Related corporations, imported fishing equipment (RR 40) 175
  - Sporting goods:
    - Rods and reels, imported, sales price (RR 40) 175
  - Tires and tubes, etc.:
    - Conforming amendments to the regulations (TD 7809) 170
    - Tire and tube weights, verification method, ruling request (RP 17) 462

Pension plans:
  - Class exemption for guaranteed contract separate accounts (PTE 81-82) 177

Period of limitation (See: Limitation period)

Private foundations:
  - Black lung benefit trusts (PL 97-119) 307

Proposed regulations:
  - 26 CFR 53.4942(a)-1(c)(2)(i), revised; 53.4942(a)-3(d)(2), amended; private foundation, minimum investment return (EE-69-80) 516
  - 26 CFR 53.4942(a)-2(b)(1), 53.4942(b)-1(a)(1), revised; private foundations distribution requirements (EE-153-81) 517
  - 26 CFR 150.4994-1, 150.4995-2, 150.4997-2(b)(1) & (d)(1), amended; exempt royalty oil (LR-313-81) 572

Proposed regulations: —Continued
  - 26 CFR 301.6106(j)(1)-1(b)(2)(i)—301.6103(j)(1)-1(b)(3), 301.6103(j)(1)-1(b)(5)(ii), 301.6103(j)(1)-1(c), 301.6103(p)(2)(B)-1, amended; disclosures of return information to the Department of Commerce (LR-111-81) 557
  - 26 CFR 301.6331-1, amended; service of notice of levy by mail (LR-160-81) 560
  - 26 CFR 301.6652-1, revised; 301.6652-2, added; penalty, underpayment of deposits, overstated deposit claims (LR-311-81) 570

Refunds and credits:
  - Articles purchased by parent-teachers association, donated to state school (RR 31) 166
  - Gasoline, resale by wholesale distributor (RR 53) 210
  - Highway use tax, foreign-owned vehicles (RR 126) 204
  - Lubricating oil, qualified business use, highway vehicle (RR 77) 211
  - Manufacturers, parts or accessories, further manufacture (RR 14) 210

Regulations:
  - 26 CFR 48.4071-3, 48.4071-4, added; 48.4071-1, 40.4071-2, 48.4072-1, 48.4073-1—48.4073-4, revised; 142.3-1, 144.1-1, 144.1-2, deleted; tires and tubes, conforming amendments (TD 7809) 170
  - 26 CFR 150.4994-1, 150.4995-2, 150.4997-2, amended; exempt royalty oil (TD 7811) 186

Reproduction of forms and returns (See: Forms)

Returns (See also: Forms):
  - Magnetic tape, windfall profit tax (RR 10) 46

Rulings:
  - Issuance procedures (RP 37) 491
  - Technical advice to District Director, issuance procedure (RP 38) 503

READEX FICHE

EXCISE TAXES—Continued

- Sales price (See: Manufacturers)
- Special fuels:
  - Articles purchased by parent-teachers association, donated to state school (RR 31) 166
  - Community action organization, state or local government exemption (RR 30) 165
- Sporting goods (See: Manufacturers)
- Statute of limitation (See: Limitation period)
- Tires and tubes, etc. (See: Manufacturers)
- Use tax:
  - Highway:
    - Articles purchased by parent-teachers association, donated to state school (RR 31) 166
    - Refund, foreign-owned vehicles (RR 126) 204
    - State or local government exemption, community action organization (RR 30) 165
- Windfall profit tax:
  - Depletion, intangible drilling and development costs, nonproductive well (RR 71) 185
  - Exempt royalty oil (TD 7811) 186
  - Inflation adjustment factor (Notice 5) 356; (Notice 14) 366
  - Liability for tax, removal of "wash" or "frac" oil (RR 41) 183
  - Magnetic tape filing (RP 10) 414
  - Severance tax adjustment:
    - Alabama, Indiana, Kentucky, Michigan, Nebraska, North Dakota, Oklahoma, South Dakota, Tennessee, Utah, Wyoming (RR 87) 189
    - Alaska (RR 89) 191
    - Arkansas (RR 90) 192
    - California, Nevada, Ohio (RR 88) 190
    - Colorado (RR 92) 194
    - Idaho, Louisiana, Mississippi, Texas (RR 86) 188
    - West Virginia (RR 91) 193

INCOME TAX

- Accounting method:
  - Change:
    - Bad debt, specific charge-off to reserve method (RP 19) 463
    - Vacation pay (RP 32) 486
  - Prepaid subscription income, postage and handling charges (RR 68) 81
- Accounting periods:
  - Change:
    - Fiscal to calendar year (RP 25) 475; (TD 7816) 75
- Additions to tax (See: Penalties)
- Administration:
  - Delegation of authority:
    - Agreements as determinations, mitigation of limitations (DO 35 (Rev. 12)) 334
    - Authority to execute returns (DO 182 (Rev. 1)) 350
    - Closing agreements (DO 97 (Rev. 19)) 337
    - Consents fixing period of limitations (DO 42 (Rev. 15)) 334; (DO 42 (Rev. 16)) 334
    - Consents to redetermination of aggregation, mining and oil and gas properties (DO 93 (Rev. 8)) 336
    - Controlled foreign corporation, minimum distributions, exclusion agreement (DO 109 (Rev. 6)) 339
    - Currency and Foreign Transactions Reporting Act of 1970 (DO 143 (Rev. 1)) 342
    - Decision on reports of refunds and credits to Joint Committee (DO 154 (Rev. 1)) 342
    - Deficiency notices (DO 77 (Rev. 15)) 335
    - Determination, tax avoidance of savings institutions (DO 107 (Rev. 6)) 339
    - Determination letters, exempt organizations (DO 113 (Rev. 7)) 340
    - Employee plans, determination and revocation letters, extensions of remedial amendment period, examination reports (DO 112 (Rev. 7)) 339

INCOME TAX—Continued

- Administration: —Continued
  - Delegation of authority—Continued
    - Extension of correction period allowable distribution period, private foundations and employee plans (DO 139 (Rev. 6)) 342
    - Extension of time, income tax returns (DO 116 (Rev. 5)) 341
    - Furnishing special statistical studies (DO 100 (Rev. 3)) 338
    - Levy on property in hands of third parties (DO 191) 352
    - Notice of additional inspection of books (DO 57 (Rev. 5)) 335
    - Reorganization of the Service (DO 4 (Rev. 13)) 331; (DO 5 (Rev. 10)) 332; (DO 8 (Rev. 8)) 333; (DO 11 (Rev. 13)) 333; (DO 14 (Rev. 2)) 333; (DO 156 (Rev. 2)) 343; (DO 156 (Rev. 2), Amend. 1) 349
    - Revocation and reestablishment of exemption (DO 88 (Rev. 6)) 335
    - Rulings, revocation of determination letters, retroactively (DO 96 (Rev. 6)) 336
    - Seizure and forfeiture of personal property (DO 157 (Rev. 3)) 350
    - Settlement recommendation letters, Department of Justice (DO 155 (Rev. 1)) 342
    - Tax treaties, competent or taxation authority (DO 114 (Rev. 3)) 341
    - Termination and jeopardy assessment (DO 160 (Rev. 3)) 350
    - Transfer of Technical and Appeals functions to Chief Counsel (DO 190) 350
  - Internal Revenue Districts, Foreign Operations, created (TDO 150-96) 511
  - Procedural rules, proposed, 26 CFR 601.502, implementation of file for authorized taxpayer representatives (LR-120-81) 559
  - Reorganization, Internal Revenue Service National Office, functions, Chief Counsel (TDO 150-95) 510

INCOME TAX—Continued
Administration: —Continued
  U.S. Court of Appeals for the Federal Circuit and U.S. Claims Court, establishment (PL 97-164) 316
Advance payments:
  Coupon clearinghouse, merchant deposits (RR 28) 11
Advertising:
  Circulation expenses, prepaid subscriptions, postage and handling charges (RR 68) 81
Affiliated corporation (See: Consolidated returns)
Allocation of income and deductions:
  Domestic international sales corporation, amended return (RR 81) 109
  Restrictions on payments by foreign subsidiaries (RR 45) 89
  Tax treaties, competent authority consideration (RP 29) 481
  U.S. subsidiary, payment received from foreign parent after allocation (RR 80) 89
Amortization:
  Bond premiums, yield method (RR 10) 46
Annuities and pensions (See also: Employee plans):
  Educational organization, arrangement administered by credit union (RR 102) 62
  Mutual fund, gross income (RR 54) 11
  Periodic report of actuary (TD 7798) 197
  Wraparound annuity contracts, earnings (RR 55) 12
Assessments (See: Limitation period)
Attorneys and agents (See: Return preparers)
Bad debts:
  Accounting change, specific charge-off to reserve method (RP 19) 463
  Deduction, thrift institutions filing consolidated return (TD 7815) 120

INCOME TAX—Continued
Banks:
  Bad debt deduction, thrift institutions filing consolidated return (TD 7815) 120
  Interest, All-Savers Certificates, constructive receipt (RR 113) 78
Basis (See: Carryover basis property)
Bonds (See also: Government obligations; Industrial development bonds):
  Government obligations, requirements for nonprofit corporation issuers, ruling requests (RP 26) 476
  Interest, issued under Housing Act of 1973 (RR 56) 17
  Mortgage subsidy, qualified mortgage bonds, qualified veterans' mortgage bonds, exempt status of interest (TD 7817) 23
  Premiums, amortization, yield method (RR 10) 46
Building and loan associations (See: Banks)
Business expenses:
  Arsonist (RR 74) 110
  Away from home, business use of home, rental of vacation home (PL 97-119) 307
  Checkwriting fees, NOW accounts (RR 59) 47
  Employer contributions, grantor trusts (RR 95) 101
  Member of Congress, away from home (PL 97-51) 306; (PL 97-92) 306; (TD 7802) 53
  Public utility, telephone wires replaced with buried cable (RR 12) 52
  Trade association, loan fund (RR 15) 29
Capital assets:
  Holding period, common stock withdrawn from profit-sharing plan (RR 75) 116
Capital expenditures:
  Intangible drilling and development costs:
  Carbon dioxide well (RR 17) 95

INCOME TAX—Continued
Capital expenditures—Continued
  Intangible drilling and development costs—Continued
    Geothermal wells (TD 7806) 91
  Public utility, telephone wires replaced with buried cable (RR 12) 52
Capital gains and losses:
  Estates and trusts (See: Estates and trusts)
  Redemptions (See: Redemption of stock and bonds)
Carrybacks and carryovers:
  Unclaimed investment credit, closed year (RR 49) 5
Carryover basis property:
  Acquired from a decedent (TD 7805) 112
Charitable contributions:
  Deduction, inventory and other property (TD 7807) 41
  Intangible drilling and development cost property (RR 9) 39
Circulation expenses (See: Advertising)
Claims (See: Limitation period)
Closing agreements:
  Rulings procedure (RP 38) 503; (RP 37) 491
Consolidated returns:
  Election, deferred intercompany transaction (RP 36) 490
  Investment credit, recapture, transfer of property in reorganization (RR 20) 6
  Thrift institutions, bad debt deduction (TD 7815) 120
Constructive ownership of stock:
  Regulated investment companies, personal holding companies (RR 107) 103
Constructive receipt of income:
  Interest, All-Savers Certificates (RR 113) 78
  Stock appreciation rights (RR 121) 79
Contracts:
  Renegotiation, Vinson-Trammell Act, filing extensions (RP 24) 474

INCOME TAX—Continued

- Contributions (See: Charitable contributions; Employee plans)
- Controlled corporations:
  - Spin-off, transfer of property, investment credit recapture (RR 20) 6
  - Surtax exemption, brother-sister controlled group, 80-percent test (CD 2010) 121
- Controlled foreign corporations:
  - Allocation of income, U.S. subsidiary, payment received after allocation (RR 80) 89
  - Subpart F income, U.S. shareholder, previously taxed income (RR 16)106
  - Transfers, domestic parent, stock to wholly-owned foreign subsidiary (RR 112) 59
- Cooperatives:
  - Farmers, nonexempt, patronage dividend (RR 76) 118
  - Integrated poultry operation (RR 51) 117
- Corporations (See also specific subject headings):
  - Charitable contributions, deduction, inventory and other property (TD 7807) 41
  - Debt or equity, treatment of certain interests in corporations (TD 7801) 60
- Credits against tax (See also specific subject headings):
  - New and targeted jobs, meals and lodging excludable from employee's gross income (RR 43) 10
  - Nonconventional source fuel, inflation adjustment factor and reference price (Notice 6) 356
  - Qualified research expense, energy conservation (PL 97-92) 306
  - Residential energy credit; allocation, condominium association members (RR 108) 3
  - Targeted jobs credit, state employment security agency, delegation of certification (RR 8) 9
- Decedents (See: Income in respect of decedents)
- Deductions (See specific subject headings)

INCOME TAX—Continued

- Deficiencies:
  - Interest, installment privilege elected, net operating loss anticipated (RR 48) 211
- Delegation of authority (See: Administration)
- Depletion:
  - Carbon dioxide well, treatment of cost of drilling source wells (RR 17) 95
  - Gross income from property, exclusion of bonus, crude oil not subject to percentage depletion (RR 3) 93
- Depreciation:
  - CLADR:
    - Half-year conventions for partnership (RR 110) 33
    - Ocean-going vessel, tax preference (RR 22) 33
  - Public utility, telephone wires replaced with buried cable (RR 12) 52
  - Rehabilitation expenditures, low-income rental housing, election (RR 103) 34
- Development expenditures (See: Exploration and development)
- Disability benefits:
  - Employer contributions, grantor trust (RR 95) 101
- Disclosure of information (See: Publicity of information)
- Dividends:
  - Patronage:
    - Nonexempt cooperative, farmers (RR 76) 118
  - Received:
    - Corporate shareholder, deduction, stock purchased after record date for payment (RR 11) 51
    - Exclusion, interest on All-Savers Certificate (RR 58) 27
- Domestic international sales corporations (DISC):
  - Amended return, income recomputed, different inter-company pricing rule used (RR 81) 109
  - Countries requiring cooperation with an international boycott (Notice 10) 359

INCOME TAX—Continued

- Domestic international sales corporations (DISC): —Continued
  - Export property, manufacture in U.S. foreign trade zone (RR 115) 108
  - Qualified export assets, goodwill (RR 18) 107
- Earnings and profits:
  - Computation, redemption of preferred stock that is section 306 stock (RR 72) 57
- Elections:
  - Prepaid subscription income, postage and handling charges (RR 68) 81
  - Section 168(f)(8) lease, reporting requirements (TD 7800) 35
- Employee annuities (See: Annuities and pensions)
- Employee plans:
  - Administrative:
    - Affiliated service group:
      - Individually designed plans, amendment (Notice 8) 357
      - Master or Prototype plans, amendment (Notice 7) 356
  - Contribution and benefits:
    - Integration with social security (Notice 2) 353
    - Qualified joint and survivorship annuities (Notice 4) 356
  - Deductions:
    - Contributions:
      - Corporate reorganization, consolidation of plans (RR 60) 63
      - Full funding limitation (RR 125) 64
  - Distributions:
    - Common stock withdrawn from profit-sharing plan, holding period (RR 75) 116
  - Exclusion of tax sheltered annuities:
    - Arrangement administered by credit union (RR 102) 62
  - Funding:
    - Limitation, defined benefit plan (RR 125) 64

INCOME TAX—Continued

- Employee plans: —Continued
  - General:
    - Effect of Economic Recovery Tax Act of 1981 (Notice 3) 353; (Notice 13) 360
    - Remedial amendment period, extension to qualify plan (RR 66) 61
  - Individual retirement programs:
    - Mutual fund, annuity contracts (RR 54) 11
    - Wraparound annuity contracts, earnings (RR 55) 12
  - Prohibited transactions:
    - Class exemption for guaranteed contract separate accounts (PTE 81-82) 177
  - Qualification:
    - Cash or deferred arrangement (Notice 1) 353
    - Integration with social security (Notice 2) 353
    - Remedial amendment period, extension to qualify plan (RR 66) 61
- Employee stock options:
  - Incentive stock options, transitional rules (TD 7799) 67
  - Related stock appreciation right (SAR) (RR 121) 79
- Estates and trusts:
  - Distribution, lifetime transfer, equalization directive (RR 4) 99
  - Grantor trusts, employer contributions (RR 95) 101
  - Pooled income funds, governing instruments, sample provisions (RR 38) 96
- Estimated tax:
  - Penalties, exception, investment credit limitation recomputed (RR 65) 213
- Exchange of property (See: Reorganizations; Sales or exchanges)
- Exempt organizations:
  - General:
    - Dissolution, state statutes providing for the distribution of assets (RP 2) 367
  - Private foundations:
    - Black lung benefit trusts (PL 97-119) 307

INCOME TAX—Continued

- Exempt organizations: —Continued
  - Qualification:
    - Trade association, loan fund (RR 15) 29
- Exploration and development:
  - Intangible drilling and development cost, capital expenditures, geothermal wells (TD 7806) 91
- Extension of time:
  - Corporate return:
    - Interest, installment privilege elected, net operating loss anticipated (RR 48) 211
    - Net operating loss anticipated (RR 47) 201
- Farmers:
  - Crop insurance proceeds, information returns (RR 93) 196
  - Losses, rice growers (RR 67) 32
- Farmers and farming (See: Cooperatives)
- Fellowships (See: Scholarships and fellowships)
- Financial institutions (See: Banks)
- Foreign corporations (See also: Controlled foreign corporations):
  - Guam, disposition of U.S. real property (RR 114) 104
- Foreign insurance companies:
  - Percentage for tax computation (Notice 11) 359
- Foreign tax credit:
  - Creditability of foreign taxes against U.S. income tax liability (RR 119) 105
  - International boycotts, countries requiring cooperation (Notice 10) 359
- Forms (See also: Returns):
  - Computer-prepared and computer-generated (RP 4) 380
  - Magnetic tape, Form 1042S (RP 13) 447
  - Reproduction:
    - 1040-ES (RP 7) 410
    - 1087 and 1099 series and W-2G (RP 5) 406
    - W-2, W-2P, and W-3 (RP 12) 429
  - Reproduction requirements (RP 3) 368

INCOME TAX—Continued

- Forms: —Continued
  - 872, limitation period, assessment, parent and subsidiaries (RP 6) 409
  - 949 and 949-A, filing extensions (RP 24) 474
- Gain or loss:
  - Recognition:
    - Building destroyed by fire, insurance proceeds (RR 74) 110
    - Exchange to effectuate policies of F.C.C., similar property (RR 70) 114
    - Stock transferred by domestic parent to wholly-owned foreign subsidiary (RR 112) 59
- Government obligations:
  - States and subdivisions (See also: Industrial development bonds):
    - Arbitrage bonds, creation of fund and issuance of general obligation bonds in related transaction (RR 101) 21
    - Bonds issued under Housing Act of 1937, interest (RR 56) 17
    - Requirements for nonprofit corporation issuers, ruling requests (RP 26) 476
  - United States or possessions (See: Bonds)
- Governmental and international organizations:
  - Multinational Force and Observers and International Food Policy Research Institute (EO 12359) 352
- Gross income (See also specific subject headings):
  - Exclusions-inclusions:
    - Advance payments, coupon clearinghouse, merchant deposits (RR 28) 11
    - Relocation assistance benefits (RR 106) 16
    - U.S. Senate employees, expense allowance (PL 97-51) 306
  - To whom:
    - Earnings, wraparound contracts (RR 55) 12
    - Mutual fund, annuity contracts (RR 54) 11
    - Stock purchased after record date for dividend payment, corporate shareholder (RR 11) 51

INCOME TAX—Continued

- Gross income: — Continued
  - When included:
    - Crop insurance proceeds paid to farmers, information returns, Federal Crop Insurance Corporation (RR 93) 196
    - Insurance proceeds received as result of arson (RR 74) 110
    - Interest, six-month money market certificate "rolled over" into an All-Savers Certificate (RR 42) 77
    - Stock appreciation rights (RR 121) 79
- Holding period:
  - Common stock withdrawn from profit-sharing plan (RR 75) 116
- Improvements (See: Capital expenditures)
- Income in respect of decedents:
  - Sale of residence completed by executor (RR 1) 26
- Individual retirement accounts (See: Employee plans)
- Industrial development bonds:
  - Exempt small issue:
    - Capital expenditure, interest (RR 117) 19
    - Qualified property (RR 44) 18
  - Qualified issue (PL 97-92) 306
  - Requirements for nonprofit corporation issuers, ruling requests (RP 26) 476
  - Ruling request:
    - Facilities operated by nonexempt management company (RP 14) 459
    - Facilities used by nonexempt person (RP 15) 460
  - Special rules, leases (TD 7800) 35
  - Trade or business test (RR 21) 17
- Information (See: Publicity of information; Returns)
- Inspection of records or returns (See: Returns)
- Installment obligations:
  - Transfer to new obligor, interest increase (RR 122) 80
- Installment sales:
  - Timber cutting rights, interest (RR 78) 30

INCOME TAX—Continued

- Insurance companies:
  - Foreign (See: Foreign insurance companies)
  - Life:
    - Indemnity reinsurance agreement (RR 69) 102
    - Mutual fund, annuity contracts (RR 54) 11
    - Wraparound annuity contracts, earnings (RR 55) 12
  - Other than life or mutual:
    - Information return, crop insurance proceeds paid to farmers, Federal Crop Insurance Corporation (RR 93) 196
- Interest:
  - Deficiencies (See: Deficiencies)
  - Exempt (See also: Industrial development bonds):
    - All-Savers Certificate (RR 58) 27
    - All-Savers Certificates, constructive receipt (RR 113) 78
    - Bonds issued under Housing Act of 1937 (RR 56) 17
    - Government obligations, requirements for nonprofit corporation issuers, ruling requests (RP 26) 476
    - Mortgage subsidy bonds, qualified mortgage bonds, qualified veterans' bonds (TD 7817) 23
  - Paid:
    - All-Savers Certificates, year of inclusion (RR 113) 78
    - Installment contract, timber cutting rights (RR 78) 30
    - Mortgage, payments by parents to student-child (RR 94) 31
    - Unstated, mortgage loans (RR 124) 89
  - Received:
    - All-Savers Certificate (RR 58) 27
    - Premature withdrawal, time savings account (RR 27) 32
    - Taxable year of inclusion, six-month money market certificate "rolled over" into an All-Savers Certificate (RR 42) 77
    - Unstated, mortgage loans (RR 124) 89

INCOME TAX—Continued

- Inventories:
  - LIFO:
    - Price indexes, department stores (RR 73) 83
    - Valuation of dollar-value, use of government price indexes (TD 7814) 84
- Investment credit:
  - Limitation recomputed, estimated tax, penalty (RR 65) 213
  - Master video tapes (RR 79) 8
  - Noncorporate lessors, limitations (RR 50) 6
  - Public utilities, energy credit, Public Utility Regulatory Policies Act of 1978 (PURPA), qualifying facility (RR 109) 7
  - Qualified person, industrial development bonds, agricultural purposes (PL 97-92) 306
  - Recapture, transfer of property in reorganization (RR 20) 6
  - Unused, carryover from closed year (RR 49) 5
- Involuntary conversions:
  - Destruction of building by arsonist (RR 74) 110
  - Sale to effectuate policies of F.C.C., similar property (RR 70) 114
- Jobs credit (See: Credits against tax)
- Leases:
  - Leveraged, electric generating facility (RR 61) 13
  - Safe harbor, information returns (PL 97-119) 307
  - Special rules, qualified mass commuting vehicles (TD 7800) 35
- Life estates and remainders:
  - Pooled income funds, governing instruments, sample provisions (RR 38) 96
- Limitation period:
  - Assessment, parent and subsidiaries, Form 872 (RP 6) 356
  - Claims, investment credit, carryover (RR 49) 5
- Loans:
  - Mortgage, unstated interest (RR 124) 89
  - Qualified mortgage bonds, qualified veterans' mortgage bonds, exempt status of interest (TD 7817) 23
- Lodging (See: Meals and lodging)

INCOME TAX—Continued

- Losses:
  - Casualty, fire, arsonist (RR 74) 110
  - Limitation, amount as risk, nonrecourse basis (RR 123) 82
  - Penalties for premature withdrawal of funds, time savings account (RR 27) 32
  - Rice growers, deduction (RR 67) 32
- Meals and lodging:
  - Foreign service member on home leave (RR 2) 27
  - State legislator, home in district (RR 33) 28
- Medical expenses:
  - Hair transplants, hair removal electrolysis, tattoos, ear piercing (RR 111) 48
- Minimum tax:
  - Tax preference, CLADR, depreciation, ocean-going vessel (RR 22) 33
- Mortgages (See: Loans)
- Moving expenses:
  - Foreign move, deduction, retirees, or dependents of decedents who were working abroad (TD 7810) 49
- Natural resources (See also: Depletion):
  - Timber cutting rights transferred to limited partnership (RR 78) 30
- Net operating loss:
  - Carryover:
    - Unused investment credit, effective date change (PL 97-119) 307
- Nonbusiness expenses:
  - Checkwriting fees, NOW accounts (RR 59) 47
  - Loss, payment to arsonist (RR 74) 110
- Nonconventional source fuel credit (See: Credits against tax)
- Obligations of government (See: Government obligations; Industrial development bonds)
- Oil and gas properties:
  - Charitable contributions, intangible drilling and development cost property (RR 9) 39

INCOME TAX—Continued

- Options (See also: Employee stock options):
  - Incentive stock options, qualification, rescission of amendment (RR 32) 66
- Partnerships:
  - Joint venture, electric generating facility (RR 61) 13
  - Valuation overstatements, penalties (RR 37) 214
- Patronage dividends (See: Dividends)
- Payment of tax:
  - Corporations, net operating loss anticipated, extension of time (RR 47) 201
  - Installment payment, interest on deficiency, net operating loss anticipated (RR 48) 211
- Penalties:
  - Failure to file actuarial report (TD 7798) 197
  - Return preparers, abated, carrybacks (RR 25) 214
  - Underpayment of estimated tax, exception, investment credit limitation recomputed (RR 65) 213
  - Valuation overstatements, partnership (RR 37) 214
- Period of limitation (See: Limitation period)
- Personal expenses:
  - Checkwriting fees, NOW accounts (RR 59) 47
  - Foreign service member on home leave (RR 2) 27
- Personal holding companies:
  - Constructive stock ownership, stock held by individual stockholder's limited partners (RR 107) 103
- Possessions of the United States:
  - Guam, corporations, disposition of U.S. real property (RR 114) 104
  - Virgin Islands, constitution approved (PL 97-21) 305
- Preference income (See: Minimum tax)
- Private foundations (See: Exempt organizations)
- Property:
  - Section 38 (See: Investment credit)

INCOME TAX—Continued

- Proposed regulations:
  - 26 CFR 1.48-9, amended; subsidized borrowing reduce business energy credits (LR-176-80) 526
  - 26 CFR 1.103-8, amended; tax-exempt bonds, mass commuting vehicles (LR-192-81) 566
  - 26 CFR 1.103-8, 1.103-10, amended; industrial development bonds, residential rental housing (LR-161-81) 561
  - 26 CFR 1.103-8(e)(2)(ii), amended; industrial development bonds, used to finance hotels at or near airports (LR-6-81) 530
  - 26 CFR 1.116-3, added; 1.854-1, 1.857-6(d), 1.1232-3A(c), amended; partial exclusion of dividends and interest from gross income (LR-83-80) 522
  - 26 CFR 1.385-0, added; 1.385-1 – 1.385-8, revised; 1.385-9, 1.385-10, deleted; 1.166-9(c), 1.171-3, 1.482-2(a)(4)(ii) – 1.482-2(a)(6), 15A.453-1(c)(8), amended; treatment of certain interests in corporations, debt or equity (LR-75-81) 531
  - 26 CFR 1.401-4, amended; employee plans, early termination of certain qualified plans (EE-11-78) 515
  - 26 CFR 1.809-4(a), 1.809-5(a), 1.811-2(a), 1.820-3(a), amended; certain amounts refunded in reinsurance transactions (LR-276-81) 567
  - 26 CFR 1.6041-1, amended; withholding, accident or health plans (LR-74-77) 520
  - 26 CFR 5e.274-8, added; travel expenses of Members of Congress, away from home (LR-4-82) 573
  - 26 CFR 53.4942(a)-1(c)(2)(i), revised; 53.4942(a)-3(d)(2), amended; private foundation, minimum investment return (EE-69-80) 516
  - 26 CFR 53.4942(a)-2(b)(1), 53.4942(b)-1(a)(1), revised; private foundations distribution requirements (EE-153-81) 517

INCOME TAX—Continued

Proposed regulations:—Continued
  26 CFR 301.6106(j)(1)-1(b)(2)(i)—301.6103(j)(1)-1(b)(3), 301.6103(j)(1)-1(b)(5)(ii), 301.6103(j)(1)-1(c), 301.6103(p)(2)(B)-1, amended; disclosures of return information to the Department of Commerce (LR-111-81) 557
  26 CFR 301.6331-1, amended; service of notice of levy by mail (LR-160-81) 560
  26 CFR 301.6652-1, revised; 301.6652-2, added; penalty, underpayment of deposits, overstated deposit claims (LR-311-81) 570
  26 CFR 304.6402-1, added; collection of past-due support, tax refunds, offset (LR-189-81) 565
Public utilities:
  Energy credit, Public Utility Regulatory Policies Act of 1978 (PURPA), qualifying facility (RR 109) 7
  Telephone wires replaced with buried cable (RR 12) 52
Publicity of information:
  Returns, mortgage subsidy bonds RP 16) 461
Redemption of stock and bonds:
  Preferred stock that is section 306 stock, computation of earnings and profits (RR 72) 57
Refunds and credits:
  Claims, limitation period, investment credit carryover (RR 49) 5
  Past-due support, offset (TD 7808) 204
Regulated investment companies:
  Constructive stock ownership, personal holding companies (RR 107) 103
Regulations:
  26 CFR 1.170A-1, 1.170A-4, 1.170A-11, amended; 1.170A-4A, added; charitable contributions, corporation, inventory and other property (TD 7807) 41
  26 CFR 1.217-2, revised; moving expenses, foreign move, retirees or dependents of decedents, working abroad (TD 7810) 49

INCOME TAX—Continued

Regulations:—Continued
  26 CFR 1.385-1, revised; treatment of certain interests in corporations, debt or equity (TD 7801) 60
  26 CFR 1.472-8, amended; dollar-value LIFO inventories, use of government price indexes (TD 7814) 84
  26 CFR 1.612-5, added; 5a.612-1, deleted; capital expenditures, intangible drilling and development cost, geothermal wells (TD 7806) 91
  26 CFR 1.1502-42, amended; thrift institutions filing consolidated return (TD 7815) 120
  26 CFR 5c.103-2, 5c.103-3, added; 5c.168(f)(8)-2, 5c.168(f)(8)-6 5c.168(f)(8)-8, amended; special rules, leases, qualified mass commuting vehicles (TD 7800) 35
  26 CFR 5c.442-1, added; acccounting period, change, fiscal year to calendar year (TD 7816) 75
  26 CFR 5e.274-8, added; travel expenses of Members of Congress, away from home (TD 7802) 53
  26 CFR 6a.103A-2, amended; exempt status of interest on mortgage subsidy bonds, qualified mortgage bonds, qualified veterans' bonds (TD 7817) 23
  26 CFR 7.1023(b)(3)-1, 7.1023(h)-1, deleted; carryover basis property (TD 7805) 112
  26 CFR 14a.422A-1, added; incentive stock options, transitional rules (TD 7799) 67
  26 CFR 301.6059-1, 301.6692-1, added; periodic reports of actuary, failure to file (TD 7798) 197
  26 CFR 301.6305-1, 301.6402-1, 301.6402-3, amended; 304.6402-1, added; refunds, past-due support, offset (TD 7808) 204
Remainders (See: Life estate and remainders)
Renegotiation (See: Contracts)
Reorganizations:
  Continuity of business, recapitalization (RR 34) 59
  Continuity of business tests (RP 23) 474

INCOME TAX—Continued

Reorganizations:—Continued
  Employee plans, consolidation (RR 60) 63
  Section 306 stock:
    Exchange of preferred stock substantially the same (RR 118) 56
    Redemption of preferred stock, computation of earnings and profits (RR 72) 57
  Spin-off, investment credit recapture (RR 20) 6
Repayments:
  Insurance proceeds received as result of arson (RR 74) 110
Reproduction of forms and returns (See: Forms)
Research and experiment:
  Credits against tax (PL 97-92) 306
Residence:
  Business expenses, away from home (PL 97-119) 307
  Business use, limitations on deferral of gain (RR 26) 114
  Sale proceeds, 55-year old taxpayer, sale by estate (RR 1) 26
Residential energy credit (See: Credits against tax)
Return preparers:
  Penalties, abated, carrybacks (RR 25) 214
Returns (See also: Consolidated returns; Forms):
  Amended, domestic international sales corporation, different intercompany pricing rule used (RR 81) 109
  Corporations, net operating loss anticipated, Forms 1138 and 7004 (RR 47) 201
  Information:
    Banks, interest, NOW accounts (RR 59) 47
    Federal Crop Insurance Corporation, crop insurance proceeds paid to farmers (RR 93) 196
    Foreign corporations, U.S. real property insterests, Guam (RR 114) 104
  Inspection, mortgage subsidy bonds (RP 16) 461

INCOME TAX—Continued

Rulings:
  - Areas in which advance rulings will not be issued (RP 22) 469; (RP 27) 480; (RP 33) 489
  - Areas in which advance rulings will not be issued:
    - Certain death benefits (RP 35) 489
    - Charitable lead interest qualifying as a guaranteed annuity interest (RP 11) 429
    - Corporate recapitalizations (RP 30) 485
    - Family partnerships (RP 28) 480
    - Incentive stock options (RP 18) 463
    - Meals or lodging, convenience of the employer (RP 8) 413
    - Partial liquidations (RP 31) 486
  - Government obligations, requirements for nonprofit corporation issuers (RP 26) 476
  - Industrial development bonds:
    - Facilities operated by nonexempt management company (RP 14) 459
    - Facilities used by nonexempt person (RP 15) 460

INCOME TAX—Continued

Rulings: —Continued
  - Issuance procedures (RP 37) 491
  - Obsolete (RR 127) 215
  - Reorganizations, continuity of business tests (RP 23) 474
  - Technical advice to District Director, issuance procedure (RP 38) 503

Sales or exchanges:
  - Like kind, gold bullion for gold coins (RR 96) 113

Savings and loan associations (See: Banks)

Scholarships and fellowships:
  - VA stipends (RR 57) 24

Self-employed plans:
  - Contributions and benefits, transition period, amendments (Notice 9) 358

Self-employment tax:
  - Community property states (RR 39) 119

Statute of limitations (See: Limitation period)

Stock:
  - Options (See: Employee stock options)
  - Redemption (See: Redemption of stock and bonds)
  - Rights, appreciation rights, year includible in gross income (RR 121) 79

INCOME TAX—Continued

Tax conventions:
  - Administrative, allocation of income and deductions, competent authority consideration (RP 29) 481
  - Arab Republic of Egypt (TC) 219
  - Jamaica (TC) 257

Timber (See: Natural resources)

Transfers to avoid tax:
  - Foreign subsidiary, stock transferred by domestic parent (RR 112) 59

Traveling expenses:
  - Foreign service member on home leave (RR 2) 27
  - Member of Congress, away from home (TD 7802) 53
  - State legislator, home in district (RR 33) 28

Trusts:
  - Employees' (See: Employee plans)
  - Estates and trusts (See: Estates and trusts)

Vacation pay:
  - Change, accounting method (RP 32) 486

Workmen's compensation (See: Disability benefits)

☆U.S. GOVERNMENT PRINTING OFFICE: 1982-361-753:153